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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1931

No. 672

PLANTERS COTTON OIL COMPANY, INC., OF WAXAHACHIE, TEXAS, ET AL., PETITIONERS,

vs.

GEORGE C. HOPKINS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF TEXAS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 1, 1932

CERTIORARI GRANTED MARCH 21, 1932

(36,486)

(36,486)

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF TEXAS

No. 4121. Law

PLANTERS COTTON OIL COMPANY, INC., et als.

versus

GEORGE C. HOPKINS, Collector of Internal Revenue

PLAINTIFFS' ORIGINAL PETITION—Filed March 8, 1930

To the Honorable Judge of said court:

Now come Planters Cotton Oil Co., Inc., Waxahachie, Texas, Planters Cotton Oil Co., Inc., Ennis, Texas, Farmers Gins, Inc., Planters Cotton Oil Company, Waxahachie, Texas, and Planters Cotton Oil Company, Ennis, Texas, hereinafter styled plaintiffs, complaining of George C. Hopkins, hereinafter styled the defendant, and allege:

I

That the Plaintiff Planters Cotton Oil Co., Inc., Ennis, Texas, is a private domestic corporation duly incorporated [fol. 2] under the laws of the State of Texas, with its principal office and place of business at Ennis in Ellis County, Texas, in the Northern District of Texas; that the plaintiff, Planters Cotton Oil Co., Inc., Waxahachie, and the Farmers Gins Inc., is each a private domestic corporation duly incorporated under the laws of the State of Texas, with its principal office and place of business at Waxahachie in Ellis County, Texas, in said Northern District of the State of Texas; that J. O. Chapman is president and Rush Hickman is secretary and general manager of each of said corporations and is a resident of said Ellis County, Texas; that Planters Cotton Oil Company, Ennis, Texas, was and is a joint stock association with its principal place of business at Ennis in Ellis County, Texas, organized and

doing business under the management of a board of directors called trustees, with the beneficial ownership therein being evidenced by certificates of interest or stock; that the Planters Cotton Oil Company, Waxahachie, is likewise a joint stock association or trust with its principal place of business at Waxahachie in Ellis County, Texas, organized and doing business under the management of a board of directors called trustees, with the beneficial ownership therein evidenced by certificates of interest or stock; that said Rush Hickman was and is the secretary-treasurer and general manager of both of said associations; that the defendant George C. Hopkins is a citizen of the United States, County of Dallas, State of Texas, and resides and has his domicile in the Northern District of Texas, within the jurisdiction of this Court, and is now and was on the dates of payment of the taxes, interest and penalties hereinafter mentioned and alleged to have been paid to him, and continuously since that time has been and now is the duly and legally appointed, qualified and acting Collector of Internal Revenue for the Second District of Texas.

[fol. 3] II

That the matter in dispute and controversy in this case arises under the Internal Revenue Laws of the United States of America as will more fully hereinafter appear, and is in amount more than $3,000.00.

III

Plaintiffs' cause of action or controversy is as follows:

The Planters Cotton Oil Company, Waxahachie, Texas, and the Planters Cotton Oil Company, Ennis, Texas, filed a timely consolidated corporation income tax return for the fiscal year ending June 30th, 1924, said companies were associations or joint stock companies taxable under the Revenue Act of 1924 as corporations and under Section 240 (b) and (c) were affiliated and were entitled to file the consolidated return.

The owners of all of the voting or common stock of said companies and the amounts owned by each were as follows:

	Planters Cotton Oil Co., Waxahachie, shares owned	Planters Cotton Oil Co., Ennis, shares owned
H. N. Chapman	1,475	2,457
R. H. Hickman	15	17
Arthur Bounds	10	26
Totals	1,500	2,500

That neither of said companies issued any other than such voting common stock.

The said consolidated corporation income tax return disclosed a net loss amounting to $206,031.03 of which $182,-[fol. 4] 284.86 was sustained by the Planters Cotton Oil Company, Waxahachie and $23,746.17 by the Planters Cotton Oil Company, Ennis.

On August 18th, 1924, the Planters Cotton Oil Co., Inc., Waxahachie, Texas, and the Planters Cotton Oil Co., Inc., Ennis, Texas, were incorporated under the laws of the State of Texas. Certain properties owned by the aforementioned associations were transferred to the said incorporated companies in consideration of the issuance of said incorporated companies of the entire amounts of their authorized capital stock, except twenty shares in each corporation, to the stockholders of the said joint stock companies.

On September 6th, 1924, the Farmers Gins, Inc., Waxahachie, Texas, was incorporated under the laws of the State of Texas, certain properties owned by the aforementioned joint stock companies was transferred to the Farmers Gins, Inc., in consideration of the issuance by said Farmers Gins, Inc., of the entire authorized capital stock except twenty shares of said Farmers Gins, Inc., to the stockholders of the said joint stock companies.

The capital stock of said three corporations was issued to the following stockholders in the amounts stated:

	Planters Cotton Oil Co., Inc., Waxahachie, shares	Planters Co. Oil Co., Inc., Ennis, shares	Farmers Gins, Inc., Waxahachie, shares
H. N. Chapman	1,940	2,940	1,204
R. H. Hickman	15	15	6
J. O. Chapman	10	10	10
Arthur Bounds	25	25	20
J. L. Gammon	10	10	10
Totals	2,000	3,000	1,250

[fol. 5] Said stock was voting common stock and no other stock was issued by said companies.

The said joint stock companies and incorporated companies filed a timely consolidated corporation income tax return for the fiscal year ended June 30th, 1925.

The said consolidated corporation income tax return disclosed consolidated net income of the affiliated group of $69,237.00. The net income or loss of each member of the affiliated group included in said return was as follows:

Planters Cotton Oil Co., Inc., Waxahachie, gain	$52,981.25
Planters Cotton Oil Co., Inc., Ennis, gain	79,476.21
Farmers Gins, Inc., Waxahachie, gain	15,178.79
Planters Cotton Oil Co., Waxahachie, Loss	$72,699.65
Planters Cotton Oil Co., Ennis, Loss	5,699.60
Consolidated Net Income	$69,237.00

Income tax in the sum of $8,654.62 was assessed upon said consolidated return against the Planters Cotton Oil Company and affiliated companies of Waxahachie and Ennis, Texas, and was paid on December 1, 1925, by the Planters Cotton Oil Company, Inc., Waxahachie, Texas, upon behalf of all of said affiliated companies liable for income tax, as well as $54.08 interest.

Subsequently, as a result of the enactment of the Revenue Act of 1926 an additional tax in the sum of $173.10 was assessed against said affiliated companies and paid on May 15th, 1926, by Planters Cotton Oil Company, Inc., Waxahachie, for the members of the said affiliated group and by it distributed as follows:

[fol. 6] Planters Cotton Oil Co., Inc., Waxahachie	$50.00
Farmers Gins, Inc.	50.00
Planters Cotton Oil Co., Inc., Ennis	73.10
Total	$173.10

In the preparation of said consolidated corporation income tax return for said fiscal year ended June 30th, 1925, the taxpayers erroneously omitted to include as a deduction in computing net income the said net loss sustained by the said joint stock companies for the fiscal year ending

June 30th, 1924, amounting to $206,031.03, as was permitted by Section 206, of the Revenue Act of 1924.

On September 15th, 1927, the said affiliated corporations and joint stock companies filed a timely claim for refund with the Collector of Internal Revenue at Dallas, Texas, setting forth their failure to properly claim as a deduction in computing net income for the fiscal year ending June 30th, 1925, the said net loss sustained for the fiscal year ended June 30th, 1924, and asking refund of the entire amount of tax paid for said fiscal year, ended June 30th, 1925.

Thereafter the books and records of the said affiliated corporations and joint stock companies were examined by John H. Way under the direction of W. L. McBride, Internal Revenue Agent in Charge, Dallas Division, and a report on said examination was issued by said Internal Revenue Agent in Charge under date of January 24th, 1928, setting forth that the consolidated returns aforesaid filed for the years ended June 30th, 1924, and June 30th, 1925, were correct as to gross income and deductions contained in said returns with the exception that the statutory net loss as shown by the consolidated corporation income tax return, filed for the year 1924, should be allowed as a deduc- [fol. 7] tion in computing net income of the consolidated group for the fiscal year ended June 30th, 1925, and said agent recommended that the claim for refund aforesaid be allowed.

That by letter of date, to-wit: March 10th, 1928, addressed to the Planters Cotton Oil Company, Inc., Waxahachie, the Commissioner of Internal Revenue notified plaintiffs, said affiliated companies, corporations and joint stock companies, that their said claim for refund had been examined and rejected and rejection thereof would officially appear on the next schedule to be approved by the Commissioner of which plaintiffs have no notice. The substance of said grounds of rejection by the Commissioner of Internal Revenue as stated in said letter is as follows:

"The claim is based upon the statement that net loss of 1924 should be applied against consolidated net income of 1925. However, the net loss for 1924 is composed of net losses of two affiliated companies only, Planters Cotton Oil Company of Waxahachie and Planters Cotton Oil Com-

pany of Ennis, whereas there are three additional companies included in the consolidation for 1925.

"The Bureau holds that where conditions obtain similar to those existing in your case the loss of each company in the year preceding the taxable year may be applied only to net income of that company in that taxable year. Inasmuch as the companies which sustained net loss in the year 1924, also sustained net loss in 1925 no adjustment for 1924 net loss may be made, and the income shown on your return for 1925 is correct."

IV

That the consolidated returns and each of them hereinbefore set out were made under authority of law, and es- [fol. 8] pecially in accordance with Section 240 of the Revenue Act of 1924 applicable thereto. Said original joint stock companies owned, controlled and operated all the properties which formed the capital stock of the incorporated companies, to-wit, the Planters Cotton Oil Co., Inc., Waxahachie, took over from the joint stock company, the Planters Cotton Oil Company, Waxahachie, the mill plant and its appurtenances at Waxahachie, Texas; and the Planters Cotton Oil Co., Inc., Ennis, took over from the Planters Cotton Oil Company, Ennis, joint stock company, the mill plant and its appurtenances at Ennis, Texas; and the Farmers Gins, Inc., took over as its capital stock from the said two joint stock companies the gin properties set out in its consolidated return of 1924, which properties were owned and operated by the said two joint stock companies for the taxable year ending June 30th, 1924. To cover which taxable year the said Planters Cotton Oil Company, Waxahachie, Texas, and Planters Cotton Oil Company, Ennis, Texas, filed their consolidated return in accordance with law and regulations prescribed by the Commissioner of Internal Revenue, and that during said taxable year and during the taxable year 1924-1925 the ownership of the properties and voting stock of each said joint stock company and corporation was more than 95 per cent in H. N. Chapman as hereinbefore set out, and that more than 95 per cent of each and all of the said interest and stock in each and all of said companies during the fiscal year ending June 30th, 1924, and the fiscal year ending June 30th, 1925, were continuously in the same interests as aforesaid; that none of

said companies or corporations had during said years outstanding any non-voting stock or stock preferred as to dividends.

V

By reason of the facts aforesaid plaintiffs are entitled to recover of and from the defendant the said sum of money [fol. 9] so paid by them, to-wit, the sum of $8,881.80 together with interest at the rate of six per cent thereon from the respective dates of payment to the date to be fixed by the Commissioner of Internal Revenue under the Acts of Congress relating thereto, particularly Section 615, of the Revenue Act of 1928.

VI

Plaintiffs allege that all the acts and conduct of the defendant herein referred to in demanding payment of the said sums of money and interest and collecting the same were done in compliance, and under instructions from the Secretary of the Treasury and the Commissioner of Internal Revenue, and were done with probable cause and upon a trial of this case as certificate of probable cause should be granted.

Wherefore, premises considered, plaintiffs pray that defendant be cited to answer this petition and upon a final hearing thereof that they have judgment against the said defendant for the sum of $8,881.80, with interest from the dates of payment to the date to be fixed by the Commissioner of Internal Revenue under the Acts of Congress relating thereto, particularly Section 615 of the Revenue Act of 1928, together with all costs of suit, and a certificate of probable cause; and such other and further judgments, orders and decrees as they or any one or more of them may be entitled to receive.

J. M. Burford, J. L. Gammon, Attorney for Plaintiffs, Waxahachie, Texas.

[fol. 10] In United States District Court

Defendant's Original Answer—Filed May 1, 1930

To the Honorable Wm. H. Atwell, Judge of said court:

Comes now Geo. C. Hopkins, Collector of Internal Revenue, defendant in the above entitled cause, and for de-

murrer and answer herein pleads and shows to the Court as follows:

1

The defendant demurs to the plaintiffs' petition and says the same is insufficient in law and shows no cause of action against him, and of this he prays judgment of the Court.

2

If required for answer herein without waiving the foregoing demurrer, the defendant denies all and singular the allegations in plaintiffs' petition contained and demands strict proof thereof, and says he is not guilty of the wrongs and trespasses or any of them alleged therein, and of this he puts himself upon the country and prays to be adjudged to go hence without day with his costs.

3

Further answering herein the defendant prays for a certificate of probable cause in the event of recovery by the plaintiffs in any sum or amount, for that the transaction of the collection of the taxes complained of was conducted by the defendant in his capacity as Collector of Internal Revenue of the United States, in pursuance of the laws [fol. 11] thereof and regulations thereunder, and the money received by him from the plaintiffs in payment of said taxes was duly covered into the treasury of the United States according to law.

Norman A. Dodge, United States Attorney, Attorney for Defendant.

IN UNITED STATES DISTRICT COURT

STIPULATION WAIVING JURY TRIAL—Filed April 15, 1930

The parties to the above entitled cause, acting by their respective counsel, hereby waive jury trial and agree that the matters of fact, as well as of law, be determined by the Court without a jury.

J. M. Burford and J. L. Gammon, Attorneys for Plaintiffs. Norman A. Dodge, United States Attorney, Attorney for Defendant.

IN UNITED STATES DISTRICT COURT

Bill of Exceptions, Order of Court Approving and Allowing Bill of Exceptions—Filed March 21, 1931

CAPTION

Be it remembered, that on the 2nd day of March, A. D. 1931, the above entitled cause came on for trial before the Court, a jury having been expressly waived by stipulation of the parties filed herein, the Honorable William H. Atwell, presiding, the plaintiff, Planters Cotton Oil Company, [fol. 12] Inc., Waxahachie, Texas, a private corporation, Planters Cotton Oil Company, Inc., Ennis, Texas, a private corporation, Farmers Gins, Inc., a private corporation, Planters Coton Oil Company, Waxahachie, Texas, a joint stock association, and Planters Cotton Oil Company, Ennis, Texas, a joint stock association, appearing by Messrs. J. L. Gammon and J. M. Burford, their counsel, and the defendant, George C. Hopkins, Collector of Internal Revenue, appearing by his counsel, Messrs. Norman A. Dodge and Wright Matthews, and the following proceedings were thereupon had:

Plaintiff offered the written stipulation of the parties, filed herein, as follows:

[Title omitted]

STIPULATION OF FACTS—Filed June 21, 1930

The parties to the above entitled and numbered cause, acting herein by their respective counsel, hereby agree that the following facts may be taken as true, subject, however, to the right of either party to introduce further evidence upon the trial of this cause, not inconsistent with the facts herein stipulated.

I

That the plaintiff, Planters Cotton Oil Co., Inc., Ennis, Texas, is a private domestic corporation, duly incorporated under the laws of the State of Texas, with its principal [fol. 13] office and place of business at Ennis, in Ellis County, Texas, in the Northern District of Texas; that the

plaintiff, Planters Cotton Oil Co., Inc., Waxahachie, and the Farmers Gins, Inc., are each a private domestic corporation, duly incorporated under the laws of the State of Texas, with its principal office and place of business at Waxahachie, in Ellis County, Texas, in said Northern District of the State of Texas; that J. O. Chapman, is President, and Rush Hickman is Secretary and General Manager, of each of said corporations, and each is a resident of said Ellis County, Texas; that Planters Cotton Oil Company, Ennis, Texas, is now and was at the time of, and prior to, the incorporation of the above named company and during all the times involved herein was a joint stock association, with its principal place of business at Ennis, in Ellis County, Texas, organized and doing business under the management of a Board of Directors called Trustees, with the beneficial ownership therein being evidenced by certificates of interest or stock; that the Planters Cotton Oil Company, Waxahachie, was likewise at said times a joint stock association, with its principal place of business at Waxahachie, in Ellis County, Texas, organized and doing business under the management of a Board of Directors called Trustees, with the beneficial ownership therein evidenced by certificates of interest or stock; that said Rush Hickman was the Secretary-Treasurer and General Manager of both of said associations; that the defendant, George C. Hopkins, is a citizen of the United States, County of Dallas, State of Texas, and resides and has his domicile in the Northern District of Texas, within the jurisdiction of this Court, and is now, and was on the dates of payment of the taxes and interest hereinafter mentioned and alleged to have been paid to him and continuously since that time [fol. 14] has been and now is the duly and legally appointed, qualified and acting Collector of Internal Revenue for the Second District of Texas.

II

That the matter in dispute and controversy in this case arises under the Internal Revenue Laws of the United States of America, as will more fully hereinafter appear, and is in amount more than $3,000.00.

III

That the aforesaid Planters Cotton Gin Company, Waxahachie, Texas, and Planters Cotton Oil Co., Ennis, Texas,

the joint stock associations, were, during the fiscal year ending June 30th, 1924, affiliated associations taxable as corporations within the meaning of the Internal Revenue Act of the United States, and that on September 15, 1924, they filed consolidated corporation tax return with the Collector of Internal Revenue, Second District of Texas, the fiscal year ending June 30th, 1924.

The owners of all of the voting or common stock of said companies and the amounts owned by each at that time and during said fiscal year, and also on the date of the incorporaiton of the corporations herein mentioned, were as follows:

	Planters Cotton Oil Co., Waxahachie, shares owned (par value $100.00)	Planters Cotton Oil Co., Ennis, shares owned (par value $100.00)
H. N. Chapman	1,475	2,457
R. H. Hickman	15	17
Arthur Bounds	10	26
Totals	1,500	2,500

[fol. 15] That neither of said companies issued or had outstanding any other than the aforesaid voting common stock. That, as disclosed by said consolidated corporation income tax return, said companies during the fiscal year ending June 30th, o924, reported a consolidated net loss amounting to $206,031.03, of which loss, the sum of $182,284.86 was reported as having been sustained by Planters Cotton Oil Co., Waxahachie, and $23,746.17 by the Planters Cotton Oil Company, Ennis.

IV

It is further agreed that on August 18, 1924, the aforesaid Planters Cotton Oil Co., Inc., Waxahachie, Texas, and the aforesaid Planters Cotton Oil Co., Ennis, Texas, were each incorporated under the laws of the State of Texas, the Waxahachie Company having a capital stock of $200,000.00, and the Ennis Company having a capital stock of $300,000.00, each of which was divided into shares of the par or face value of $100.00.

V

That after the two corporations aforesaid were formed, mentioned and set out in the last preceding paragraph hereof, a third corporation, Farmers Gins, Inc., was, on the 6th day of September, 1924, incorporated under and by virtue of the laws of the State of Texas, with a capital stock of $125,000.00, divided into 1,250 shares of the par value of $100.00 each. That said Planters Cotton Oil Co., of Waxahachie, and the Planters Cotton Oil Co., of Ennis, the two joint stock associations, the Planters Cotton Oil Co., Inc., of Waxahachie, and the Planters Cotton Oil Co., of Ennis, and the Farmers Gins, Inc., were during the [fol. 16] fiscal year, ending, June 30th, 1925, affiliated within the meaning of the Internal Revenue Acts of the United States.

VI

That after the formation of the three corporations herein above mentioned, the stock therein was issued and held as follows:

	Planters Cotton Oil Co., Inc., Waxahachie, shares	Planters Cotton Oil Co., Inc., Ennis, shares	Farmers Gins, Inc., shares
H. N. Chapman	1,940	2,940	1,204
R. H. Hickman	15	15	6
J. O. Chapman	10	10	10
Arthur Bounds	25	25	20
J. L. Gammon	10	10	10
Totals	2,000	3,000	1,250

That the stock in the aforesaid corporations was issued in consideration of a transfer of certain assets to them respectively by the Planters Cotton Oil Co., of Waxahachie, and the Planters Cotton Oil Co., of Ennis, the joint stock associations, which transferred assets constituted the entire assets of said corporations. All of the stock therein was common and voting stock, and fully paid as aforesaid.

VII

That on September 17th, 1925, said stock companies and incorporated companies filed with the Collector of Internal

Revenue for the Second District of Texas, a consolidated corporation income tax return for the fiscal year which [fol. 17] ended June 30, 1925, a certified photostat copy of which is attached hereto and made a part hereof and marked "Exhibit A". Said affiliated group, as disclosed by said income tax return, reported a net income for the fiscal year ending June 30th, 1925, of $69,237.00. That the following members of said affiliated group realized a net income as follows:

Planters Cotton Oil Co., Inc., Waxahachie	$52,981.25
Planters Cotton Oil Co., Inc., Ennis	79,476.21
Farmers Gins Inc., Waxahachie	15,178.79
Total	$147,636.25

That the following members of said affiliated group realized a net loss as follows:

Planter Cotton Oil Co., Waxahachie	$72,699.65
Planters Cotton Oil Co., Ennis	5,699.60
Total	$78,399.25

That the consolidated net income, as aforesaid, of said affiliated group for said year amounted to the sum of $69,237.00, and that an income tax was assessed upon such net income in the sum of $8,654.62 against the Planters Cotton Oil Co., Waxahachie, the designated parent company, and the aforesaid affiliated companies of Waxahachie and Ennis, which, together with an additional amount of $54.80 interest was paid to the defendant on December 4th, 1925, by the Planters Cotton Oil Co., Inc., Waxahachie, upon behalf of all of the above mentioned affiliated companies liable for income tax. Subsequently, an additional tax in the sum of $173.10 was assessed against Planters Cotton Oil Co., Inc., Waxahachie, and said affiliated Companies, and paid [fol. 18] to defendant on May 19, 1926, by Planters Cotton Oil Co., Inc., Waxahachie, for the member of said affiliated group liable for income tax.

VIII

That in the preparation of said consolidated corporation income tax return, and the schedules filed therewith, for

said fiscal year ending June 30th, 1925, no claim was made for any deduction with respect to the losses reported by the said joint stock companies in the consolidated returns filed by said joint stock companies for the fiscal year ending June 30th, 1924.

IX

On September 15, 1927, the Planters Cotton Oil Co., Inc., Waxahachie, in its own behalf and in behalf of the above mentioned affiliated companies, filed a claim for refund with the defendant herein, the Collector of Internal Revenue, at Dallas, Texas, a certificate photostat copy of which is attached hereto, marked "Exhibit B," and made a part hereof; that on the same date, the Planters Cotton Oil Co., Inc., Waxahachie, as such parent company, filed an amended consolidated return, a certified photostat copy of which is hereto attached, and made a part hereof, and marked "Exhibit C," for the year ending June 30, 1925.

X

It is further agreed that the net loss sustained by the Planters Cotton Oil Company of Waxahachie, and the Planters Cotton Oil Co., of Ennis, the two joint stock associations, during the fiscal year ending June 30, 1924, was sufficient to offset the total net income realized by the three corporations, to-wit, Planters Cotton Oil Co., Inc., Waxa-
[fol. 19] hachie, Planters Cotton Oil Co., Inc., of Ennis, and Farmers Gins, Inc., during the fiscal year ending June 30, 1925, and that if the net loss sustained by the two joint stock associations for the fiscal year ending June 30th, 1924, may be used as a deduction in computing the net income of the two joint stock associations for the fiscal year ended June 30th, 1925, and the net loss of said two associations thus determined may be applied against the net incomes of the three corporations, then the consolidated group, consisting of the three incorporated companies and two joint stock associations, had no taxable net income for the fiscal year ended June 30, 1925, and there was no tax due from said above plaintiffs for the taxable year ending June 30, 1925.

XI

That if the plaintiffs recover herein, it is further agreed that said recovery shall be apportioned among the affiliated companies as follows:

Planters Cotton Oil Co., Waxahachie	None
Planters Cotton Oil Co., Ennis	None
Planters Cotton Oil Co., Inc., Waxahachie	53/147ths
Planters Cotton Oil Co., Inc., Ennis	79/147ths
Farmers Gins, Inc.	15/147ths

That by letter of date March 10, 1928, addressed to the Planters Cotton Oil Company, Inc., Waxahachie, the Commissioner of Internal Revenue notified plaintiffs said affiliated companies, corporation and joint stock companies, that their said claim for refund had been examined, and would be rejected, and rejection thereof would officially appear on the next schedule to be approved by the Commissioner, which was so approved on the 26th day of [fol. 20] March, 1928. The substance of said grounds of rejection by the Commissioner of Internal Revenue, as stated in said letter, is as follows:

"IT:CR:E. JFD.

March 10, 1928.

Planters Cotton Oil Company, Incorporated, Waxahachie, Texas.

SIRS: Your claim for refund of $8,827.72, corporation income tax for the fiscal year ended June 30th, 1925, has been examined, and will be rejected.

The claim is based upon the statement that net loss of 1924 should be applied against consolidated net income of 1925. However, the net loss of 1924 is composed of net losses of two affiliated companies, only, namely, Planters Cotton Oil Company of Waxahachie, Planters Cotton Oil Company of Ennis, whereas, there are three additional companies included in the consolidation for 1925.

The Bureau holds that where conditions obtain similar to those existing in your case, the loss of each company in the year preceding the taxable year may be applied only to net income of that company in that taxable year, inasmuch as the Companies which sustained net losses in 1924 also

sustained net losses in 1925, no adjustment for 1924 net loss may be made and the income shown on your return for 1925 is correct.

The rejection of this claim will officially appear on the next schedule to be approved by the Commissioner.

Respectfully, C. B. Allen, Deputy Commissioner, by H. B. Robinson, Head of Division."

MdeH-3.

[fol. 21] That said claim for refund has been denied as aforesaid, and has not been reopened, and no part thereof has been paid.

In testimony whereof witness our hands this the 20th day of June, A. D. 1930.

(Signed) J. M. Burford, (Signed) J. L. Gammon, Attorneys for Plaintiffs. (Signed) Norman A. Dodge, United States District Attorney for the Northern District of Texas, for Defendant, (Signed) by Wright Matthews, Special Attorney, Bureau of Internal Revenue.

[File endorsement omitted.]

[Title omitted]

MOTION FOR JUDGMENT ON BEHALF OF PLAINTIFFS—Filed March 2, 1931

Now come the plaintiffs in the above entitled and numbered cause, and move the Court for judgment on the following grounds, to-wit:

I

The uncontradicted evidence in this case, as stipulated by the parties, shows that the net losses sustained by the Planters Cotton Oil Company of Waxahachie and the Planters Cotton Oil Company, of Ennis, during the taxable year ending June 30, 1924, together with the net losses sustained by the Planters Cotton Oil Company of Waxa-
[fol. 22] hachie and the Planters Cotton Oil Company of Ennis for the taxable year ending June 30, 1925, exceeded

the net income of the five affiliated companies, to-wit, the Planters Cotton Oil Company of Waxahachie, the Planters Cotton Oil Company of Ennis, the Planters Cotton Oil Company, Inc., of Waxahachie, the Planters Cotton Oil Company, Inc., of Ennis, and the Farmers Gins, Inc., of Waxahachie, during the taxable year ending June 30, 1925, and that the losses sustained by Planters Cotton Oil Company of Waxahachie and the Planters Cotton Oil Company of Ennis, as a matter of law, during the taxable year ending June 30, 1924, may be used to reduce the net income of the five affiliated companies for the taxable year ending June 30, 1925, and that when so used to reduce such consolidated income, there was no net income on the part of said affiliated companies, and no tax due or payable.

II

The defendant in this case has adduced no substantial and/or sufficient evidence which warrants a judgment in favor of the defendant and against the plaintiffs.

III

As a matter of law, the taxes sought to be recovered herein were illegally assessed and unlawfully collected and are illegally and unlawfully withheld by the defendant in this case.

IV

That under the facts and the law, the plaintiffs are entitled to judgment as prayed for in their petition on file [fol. 23] herein, and plaintiffs request that if this motion be denied, that their exception be duly noted.

(Signed) J. M. Burford, (Signed) J. L. Gammon,
Attorneys for Plaintiffs.

[File endorsement omitted.]

MOTION FOR JUDGMENT ON BEHALF OF DEFENDANT—Filed March 2, 1931

[Title omitted]

Now comes the defendant in the above entitled and numbered cause and moves the Court for judgment on the following grounds, to-wit:

I

The plaintiffs have in this case adduced no substantial and/or sufficient evidence which warrants a judgment in their favor and against this defendant,

II

That the net losses sustained by the Planters Cotton Oil Co., at Waxahachie, and the Planters Cotton Oil Co., Ennis, during the taxable year ended June 30, 1924, at a time when these two associations were not affiliated with any other corporations or associations, may not be used to reduce the net income of Planters Cotton Oil Co., Inc., Waxahachie, Planters Cotton Oil Co., Inc., Ennis, and Farmers Gins, Inc., Waxahachie, during the taxable year ended June 30, 1925, at a time when the first above mentioned two associations were affiliated with the latter three named corporations and under the law entitled to file a consolidated [fol. 24] return with said corporations, the said two associations having sustained losses in the taxable year ended June 30, 1925.

III

That the taxes sought to be recovered herein were legally assessed and lawfully collected by this defendant.

IV

That on the facts and the law defendant is entitled to judgment dismissing plaintiffs' petition at their cost.

Defendant requests that if this motion be denied, that his exception be duly noted.

(Signed) Norman A. Dodge, United States Attorney,
(Signed) Wright Matthews, Special Attorney, Bureau of Internal Revenue, Attorneys for Defendant.

[File endorsement omitted.]

JUDGMENT—Filed March 3, 1931

[Title omitted]

On this the 2nd day of March, 1931, came on for trial the above entitled cause and appeared the parties by their

counsel and announced ready for trial, and the matters of fact as well as of law being submitted to the Court without a jury, jury trial having been expressly waived by stipula-
[fol. 25] tion of the parties filed herein, the Court after hearing the evidence and argument of counsel is of opinion the law is for the defendant, and both parties having filed motions for judgment, the motion of defendant is granted and the motion of the plaintiffs denied.

It is therefore the order and judgment of the Court that the plaintiffs take nothing by their suit herein and that the defendant collector go hence without day with his costs.

To which action of the Court in granting the defendant's motion for judgment and denying the plaintiff's motion therefor, and in entering judgment for defendant, the plaintiffs excepted and their exception was allowed by the Court.

(Signed) Wm. H. Atwell, United States District Judge.

[File endorsement omitted.]

STIPULATION RE EXHIBITS "A" TO "C"—Filed March 21, 1931

[Title omitted]

Whereas, in the above styled and numbered cause, the parties, plaintiffs, and defendant, prior to the trial of said cause, stipulated in writing the facts therein which was duly filed herein, and to which stipulation was attached certain exhibits, as follows:

Exhibit "A".—A certified photostat copy of the consolidated corporation income tax return, for the fiscal year ending June 30, 1925, made by the Planters Cotton Oil Company, Inc., Waxahachie, Planters Cotton Oil Company, Inc., Ennis, Farmers Gins, Inc., Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, affiliated corporations, the Planters Cotton Oil Com-
[fol. 26] pany, Inc., Waxahachie, being the designated parent company, which return was duly filed with the Collector of Internal Revenue, Second District of Texas, and which exhibit is mentioned in Paragraph VII of the stipulation.

Exhibit "B".—A certified photostat copy of a claim for refund in the amount herein sued for, filed by the Planters Cotton Oil Company, Inc., Waxahachie, in its own behalf and in behalf of the above mentioned affiliated companies filed on the 15th day of September, A. D. 1927, with the defendant herein, Collector, Internal Revenue, Dallas, Texas, Second District of Texas, and which exhibit is mentioned in Section IX of the stipulation.

Exhibit "C".—A certified photostat copy of an amended consolidated return, filed on the 15th day of September, 1927, by Planters Cotton Oil Company, Inc., Waxahachie, as parent company for and on behalf of the aforesaid affiliated companies, for the fiscal year ending June 30, 1925, and which is mentioned in Paragraph IX of said stipulation, and

Whereas, no question was or is now being made or has been raised as to the sufficiency of said returns, or either of them or of the claim filed for refund, certified photostat copies of which constitute the aforesaid Exhibits A, B and C, attached to the stipulation, and in order to expedite the preparation of the record upon appeal, and to save cost in its preparation, it is hereby agreed by and between the parties, by and through their respective duly authorized attorneys of record, as follows:

1. That said record for appeal may be prepared and the stipulation be included therein, without copying or otherwise carrying up or including therein said exhibits, or any of them, above mentioned.

[fol. 27] 2. That said returns, and said claim for refund set out in said Exhibits A, B and C, were in all respects regular and in due and legal form, and no question was raised upon the trial of said cause as to their sufficiency or regularity either as to form or substance, or as to the date and place of their filing, and no question thereof is now being raised; and it is further agreed that in considering the assignments of error in this cause on appeal, said assignments may be considered for all purposes the same as if said exhibits were copied in the record.

In testimony whereof the parties have hereunto set their hands by their respective attorneys on this the 20th day of March, A. D. 1931.

Planters Cotton Oil Company, Inc., Waxahachie; Planters Cotton Oil Company, Inc., Ennis; Farmers Gins., Inc., Planters Cotton Oil Company, Waxahachie; Planters Cotton Oil Company, Ennis, Plaintiffs, by J. L. Gammon. J. M. Burford, Attorneys for Plaintiffs. George C. Hopkins, Collector Internal Revenue, Defendant, by Norman A. Dodge, Wright Matthews, Attorneys for Defendant.

[File endorsement omitted.]

[fol. 28] (Title omitted)

FINDINGS OF FACT AND CONCLUSIONS OF LAW—Filed March 21, 1931

Upon motion of plaintiffs, duly made, the Court makes and files this, his Findings of Facts and Conclusion of Law herein:

Findings of Facts

I find the facts in this cause to be as set out in the stipulation of the parties filed herein, which stipulation is here referred to and in all things adopted and made a part of the Court's findings.

I further find, as stipulated by the parties, that certain exhibits are attached to said stipulation and consisting of the following documents described as follows:

(1) Exhibit "A", mentioned in Paragraph VII of the stipulation, containing a certified photostat copy of a consolidated corporation income tax return for the fiscal year ending June 30th, 1925, of the following affiliated members:

Planters Cotton Oil Co., Inc., Waxahachie;
Planters Cotton Oil Co., Inc., Ennis;
Farmers Gins, Inc.,
Planters Cotton Oil Co., Waxahachie;
Planters Cotton Oil Co., Ennis,

which return was duly filed by the Planters Cotton Oil Co., Inc., designated parent Company, with the Collector of Internal Revenue, Second District of Texas.

(2) Exhibit "B", mentioned in Paragraph IX of the stipulation, which is composed of a certified photostat copy of a claim filed for refund, by the Planters Cotton Oil Co., [fol. 29] Inc., in its own behalf and in behalf of the affiliated companies mentioned in Section (1) hereof, which claim was duly fixed with the defendant herein, Collector of Internal Revenue, Second District of Texas.

(3) Exhibit "C", which is a certified photostat copy of an amended consolidated corporation income tax return filed by the Planters Cotton Oil Company, Inc., Waxahachie, the designated parent company, for the fiscal year ending June 30th, 1925, of the five affiliated companies hereinabove mentioned, which was duly filed with the defendant herein, Collector of Internal Revenue, Second District of Texas.

No question having ben raised upon the trial of this cause as to the sufficiency, either in form or contents, of said Exhibits, or any of them, or as to the time and place of the filing thereof, the Court hereby, further finds that the consolidated corporation income tax return for the fiscal year ending June 30th, 1925, duly filed, and being Exhibit "A" above mentioned, the claim for refund duly filed, and being Exhibit "B" above set out, and the amended consolidated corporation income tax return filed for the fiscal year ending June 30th, 1925, referred to above in Exhibit "C", were, each and all of them legally sufficient, both in form and contents, and that the same, and each of them, were duly filed at the time and in the place and manner provided and required by law, and that the same were legally sufficient, upon the application for refund being denied, to comply with all legal conditions precedent to the filing and prosecution of this suit.

And in order to expedite the preparation of the record upon appeal herein, and in order to save cost in the prepa- [fol. 30] ration thereof, it is ordered that said Exhibits be detached from the Stipulation and not be carried forward in the record upon appeal.

I further find that the application for refund was denied and that this suit was thereafter brought, within the time provided by law, in such cases made and provided.

Declaration of Law

From the foregoing facts, I conclude:

That the losses sustained by the Planters Cotton Oil Co., Waxahachie, Texas, and Planters Cotton Oil Co., Ennis, Texas, affiliated corporations, for the taxable year ending June 30th, 1924, cannot be used as a deduction in computing the income of said companies for the fiscal year ending June 30th, 1925, for the reasons:

First. Each of said companies that sustained losses for the fiscal taxable year ending June 30th, 1924, sustained net losses for the succeeding fiscal taxable year ending June 30th, 1925, and that the loss of each company for the year preceding the taxable year may be applied only to net income of that company in the taxable year.

Second. For the taxable year ending June 30th, 1924, there were only two members of the taxable affiliated group, whereas, for the taxable year ending June 30th, 1925, there were five members of the affiliated taxable group. On account of the addition of the three new members to the affiliated group during the taxable year, the losses sustained by any original member of the group for the year preceding the taxable year is not allowable in computing its income for the taxable year when this same [fol. 31] member sustained losses in the taxable year, to which Conclusions of Law plaintiffs except.

Dated this the 21st day of March, A. D. 1931.

(Signed) Wm. H. Atwell, Judge.

[File endorsement omitted.]

In United States District Court

Order Approving Bill of Exceptions

The plaintiff tenders and presents the foregoing as its bill of exception in this case to the action of the Court, and

prays that same be settled and allowed, and filed and sealed by the Court, and made a part of the record, and the same is accordingly done, on this 21 day of March, 1931, during the term of Court at which the above proceedings were had, and the Court here and now on this the 21st day of March, 1931, approves, allows and orders filed this bill of exceptions.

Wm. H. Atwell, United States District Judge for the Northern District of Texas, Presiding at the Trial of said cause.

O. K.

J. M. B., for Pltffs.

O. K.

Dodge, U. S. Attorney; W. Matthews, Spec. Atty., Bureau of Internal Revenue, for Defts.

Judgment omitted from the printed record, being heretofore copied at page 24.

[fol. 32] IN UNITED STATES DISTRICT COURT

Suit to Recover Payment of Income Taxes

J. L. Gammon, Waxahachie, Texas; Worsham, Rollins, Burford, Ryburn & Hicks, Dallas, Texas, for the plaintiff.

Norman A. Dodge, United States Attorney, Fort Worth, Texas, Wright Matthews, Special Attorney, Bureau of Internal Revenue, Washington, D. C., for the defendant.

OPINION OF THE COURT—Filed March 11, 1931

The five plaintiffs are associations in which Homer Chapman owned and owns over ninety-five percent of the stock. (Section 993, U. S. C. A., affiliated corporations.) Two of the five, the original Waxahachie and Ennis companies, were affiliated in 1924, and out of their assets, were created three new companies, two of which bear the same names as the old companies, and the third of which is known as the Farmers Gins, Incorporated. Chapman was, therefore, in reality the taxpayer. It is true the artificial persons were named as the respective units and the tax

was figured for each of those units, but the result of the year's work was a benefit or a loss to Chapman, and the tax was, in reality, paid by him, because he owned the companies.

The trend of judicial pronouncement, as well as the trend of legislation, is that the taxpayer shall pay on income, and only upon income. Affiliation of artificial persons works no exception. Under the present statute affiliation is unenforced, until once enjoyed. The cycle idea in business [fol. 33] is a recognition of the fact that one year may be helpful and another year hurtful—one year may be adverse and another prosperous—and supports the suggestion that, after all, the taxpayer's fortune was in the mind of the congress, even as was the thought that the government should have its exact due, without being cheated out of the same by the juggling of earnings and losses, or, by bookkeeping credits and charges of corporations controlled by the same interests.

Affiliation may, therefore, be for the interest of both taxpayer and gatherer even though some of the cases indicate its use for the benefit of the gatherer only.

In re Trentor Corn Products Co., 299 F., 326; 4 F. (2) 195; 5 B. T. A., 499.

The original Waxahachie and Ennis concerns show the consolidated net loss of $206,031.03 for the fiscal year ending June 30th, 1924. On August 18th, 1924, two of the new concerns were incorporated, and on September 6th, 1924, the third was born. Assets of the old associations were the consideration for stock in the three new ones, and for the taxable year ending June 30th, 1925, the five organizations made a consolidated return. This showed a net income for that year of $69,237.00, made up of $147,636.25, net income by the three new members, and a net loss of $78,399.25, by the two old ones. If the 1924 losses of the two originals had been utilized this net income would have been wholly destroyed, and there would have been no tax. Upon payment of the tax claim for refund was refused and this suit followed.

The plaintiffs contend that the loss suffered by the two original affiliated associations for the year 1924, may be used for the benefit of the 1925 computation.

[fol. 34] The question is troublesome. The use that may be made of a loss is not clear.

18 B. T. A., 537;
19 B. T. A., 81;
18 B. T. A., 919;
16 B. T. A., 945;
16 B. T. A., 1310;
19 B. T. A., 943.

Then, too, there is the Sweets case, 40 F., (2) 436, and, Swift & Co., vs. U. S. 38 F., (2) 363. This latter case dealt with a statute somewhat different from 206 (b), Article 937, Act of 1926. The statute there was the one which authorized the commissioner to deduct a net loss for a subsequent year from the net income of a preceding year, while the statute which regulates this case authorizes the commissioner to deduct a preceding loss from a gain of the following year. Judge Sibley, in Woolford Realty Company vs. Rose, 44 F., (2) 856, wrote about the identical question at bar and supports the defendant's contention, the Commissioner's action in refusing the refund.

It may be said that while, with one exception, the reasoning of the learned writers in the above mentioned cases, may not be upon facts exactly on all fours with those of the cause we are considering, the drift thereof is against the position of the defendant. I am not sure that optional affiliation, until once enjoyed or compelled, has any bearing upon a correct solution, but, the exact wording of the other statute cannot be ignored. "If, for any taxable year, it appears from the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeed-[fol. 35] ing year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary." 206 (b), Art. 937, Act 1926.

The tax of each member of an affiliated group is complete within itself. It is calculated without reference to the

figures, or the results of any other. The aggregate result of such individual calculations becomes the computing unit. Without the words, "computed without such deduction," the statute would be even less clear, but, with those words we need not write anything into the statute in order to limit the prior losses to the use and benefit of the taxable unit which actually made such losses, if and when there is no excess of a net loss over a net income for the subsequent year. If the net loss sustained in 1924 is used as a deduction in computing the taxpayer's net income for 1925, nothing could be carried forward to 1926, which would be, within the statute the third year of the completed cycle. I think the statute means that the two associations which sustained the net loss in 1924 could not have such net loss used as deductions in computing their net income for 1925, because such net income computed without such deduction resulted in losses and the plain wording of the statute requires that such net losses be carried forward and used as deductions in computing the net income for such taxpayers for 1926. Affiliation is of no consequence to such calculation. There must be a calculation within the terms of the law for each individual unit before a computation for the affiliated unit [fol. 36] can be used. A different basis allows evils sometimes against the payer and sometimes against the receiver, but this reading and construction preserves both, and affords a support for the belief that there was a due consideration for both in the mind of the congress.

The motion of the defendant for a verdict is sustained.

Wm. H. Atwell, United States District Judge.

At Dallas, March 2nd, 1931.

IN UNITED STATES DISTRICT COURT

PETITION FOR APPEAL—Filed March 21, 1931

Now comes Planters Cotton Oil Company, Inc., Waxahachie, Texas, a private corporation, Planters Cotton Oil Company, Inc., Ennis, Texas, a private corporation, Farmers Gins, Inc., a private corporation, Planters Cotton Oil Company, Waxahachie, Texas, a joint stock association, and Planters Cotton Oil Company, Ennis, Texas, a joint stock

association, plaintiffs herein, and say that on or about the 2nd day of March, A. D., 1931, this Court entered judgment herein in favor of the defendant, George C. Hopkins, Collector of Internal Revenue, and against these plaintiffs, in which judgment, and the proceedings had prior thereunto in this cause, certain errors were committed to the prejudice of these plaintiffs, and each of them, all of which will more in detail appear from the assignment of errors which is filed with this petition.

[fol. 37] Wherefore, the above named plaintiffs, and each of them, conceiving themselves aggrieved by the judgment entered herein, as aforesaid, do hereby appeal from said judgment to the Honorable United States Circuit Court of Appeals for the Fifth Circuit, under and according to the laws of the United States in that behalf made and provided, for the reasons specified in said assignment of errors, and pray that this appeal be allowed, and that a transcript of the record, proceedings and papers, upon which judgment was entered, duly authenticated, may be sent to the United States Circuit Court of Appeals for the Fifth Circuit.

J. L. Gammon, J. M. Burford, Attorneys for Plaintiffs.

IN UNITED STATES DISTRICT COURT

ASSIGNMENTS OF ERROR—Filed March 21, 1931

Come now the plaintiffs, Planters Cotton Oil Company, Inc., Waxahachie; Planters Cotton Oil Company, Inc., Ennis; Farmers Gins, Inc., Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, and file the following assignment of errors upon which they and each of them will rely in the prosecution of their appeal in the above entitled and numbered cause:

I

The Court erred in refusing to grant and in denying the motion of these plaintiffs for judgment herein, which mo-

[fol. 38] tion was duly made, and presented, and on file herein.

II

The Court erred in granting and in not denying the motion of the defendant for judgment herein.

III

The Court erred in rendering judgment herein in favor of the defendant and in not rendering judgment for plaintiffs as prayed in that the uncontradicted evidence shows that the losses incurred by the Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, for the taxable year ending June 30, 1924, was more than sufficient to off-set the net consolidated income of the five affiliated companies, to-wit: Planters Cotton Oil Company, Inc., Waxahachie; Planters Cotton Oil Company, Inc., Ennis; Farmers Gins, Inc.; Planters Cotton Oil Company, Waxahachie; and Planters Cotton Oil Company, Ennis, for the succeeding taxable year ending June 30, 1925, and as a matter of law, said losses sustained by the two affiliated companies, above named, for the taxable year ending June 30, 1924, was and is allowable as a deduction in computing the income of the respective companies, to-wit: Planters Cotton Oil Company, Waxahachie and Planters Cotton Oil Company, Ennis, for the succeeding taxable year ending June 30, 1925, and, if allowed as such deduction, in computing their respective incomes for the taxable year ending June 30, 1925, there was no tax due by the affiliated group for the taxable year ending June 30, 1925, whereas, the uncontradicted evidence further shows that plaintiffs paid a tax for said taxable year ending June 30, 1925, in the amount sued for herein.

[fol. 39]

IV

The Court erred in holding that the losses sustained by the two companies, Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, respectively, for the taxable year ending June 30, 1924, could not be allowed by said companies in computing their respective incomes for the succeeding taxable year ending June 30, 1925, for if such losses were allowed in computing their respective net incomes for the succeeding taxable year ending June 30, 1925, there was no tax whatsoever due for the taxable year ending June 30, 1925.

Wherefore plaintiffs pray that the judgment of the District Court be reversed, and that such orders may be made as comport with right and justice.

J. L. Gammon, J. M. Burford, Attorneys for Plaintiffs.

IN UNITED STATES DISTRICT COURT

ORDER ALLOWING APPEAL—Filed March 21, 1931

On this the 21st day of March, A. D. 1931, came plaintiffs, Planters Cotton Oil Company, Inc., Waxahachie, Texas, a private corporation, Planters Cotton Oil Company, Inc., Ennis, Texas, a private corporation, Farmers Gins, Inc., a private corporation, Planters Cotton Oil Company, Waxahachie, Texas, a joint stock association, and Planters Cotton Oil Company, Ennis, Texas, a joint stock association, and presented their petition for an order allowing them to appeal to the Honorable United States Circuit [fols. 40-42] Court of Appeals for the Fifth Circuit from the final judgment heretofore rendered and entered against them in the above named cause, on to-wit: the 2nd day of March, A. D. 1931, under and according to the laws of the United States in that behalf made and provided; and it appearing that the plaintiffs have filed in said cause an assignment of errors and a prayer for reversal of the judgment so rendered against them in said cause; it is here and now ordered that said petition of plaintiffs be, and same is hereby granted, and that the appeal to the Honorable United States Circuit Court of Appeals for the Fifth Circuit be, and same is hereby allowed as prayed for.

It is further ordered that the bond on said appeal be, and same is hereby fixed at the sum of Two Hundred Fifty ($250.00) Dollars, payable and conditioned as provided by law, and to be approved by this Court.

Dated at Dallas, Texas, this 21 day of March, A. D. 1931.

Wm. H. Atwell, Judge United States District Court for the Northern District of Texas.

Bond on appeal for -250.00, approved and filed March 21, 1931, omitted in printing.

[fol. 43] IN UNITED STATES DISTRICT COURT

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed —— —, ——

To the clerk of said court:

We hereby respectfully request you to make up a transcript of the record in the above case to include the following:

1. Caption.
2. Plaintiffs' Original Petition.
3. Defendant's Original Answer.
3-a. Stipulation of parties waiving jury.
4. Bill of Exceptions.
5. Order of Court approving and allowing Bill of Exceptions.
6. Judgment of the Court.
7. Petition for Appeal and accompanying Assignments of Error.
8. Order allowing appeal.
9. Appeal Bond.
10. Citation on Appeal with Waiver of Service.
11. Præcipe.
12. Clerk's Certificate.

Yours very truly, J. L. Gammon, J. M. Burford, Attorneys for Plaintiffs.

[fol. 44] Citation, in usual form, showing service on Geo. C. Hopkins, filed March 21, 1931, omitted in printing.

[fol. 45] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 46] Minute entry of argument and submission, November 6, 1931, omitted in printing.

[fol. 47] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 6243

PLANTERS COTTON OIL COMPANY, INC., Waxahachie, Texas, et al., Appellants,

versus

GEORGE C. HOPKINS, Collector of Internal Revenue, Appellee

Appeal from the District Court of the United States for the Northern District of Texas

(November 20, 1931)

Before Bryan, Foster, and Hutcheson, Circuit Judges

OPINION OF THE COURT—Filed November 20, 1931

HUTCHESON, Circuit Judge:

The consolidated return for the fiscal year ending June 30, 1924 of Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, unincorporated associations, 98% of the stock of which was owned by Chapman, showed a net loss of $206,031.03. Of this total $182,284.86 was the loss of the Waxahachie company, $23,746.17 of the Ennis company. For reasons of his own not disclosed by the stipulation on which the case was tried Chapman in August and September 1924 caused to be formed under the laws of Texas three corporations, Planters Cotton Oil Co. Inc. Waxahachie, Planters Cotton Oil Co. Inc. Ennis, [fol. 48] and Farmers Gins, Inc. and to be transferred to them certain of the assets of the associations. In consideration of their transfer there was issued to Chapman substantially all of the stock of the three corporations. These assets so transferred constituted the entire assets of the corporations.

For the fiscal year ending June 30, 1925 the three corporations and the two joint stock companies filed a consolidated tax return reporting a net income of $69,237.00 made up of a net income of the three corporations of $147,636.25, a loss of the two associations of $78,399.25. The tax as-

sessed upon this return was paid for the group by Planters Cotton Oil Co. Inc. Waxahachie. No claim to a deduction for the net losses sustained by the unincorporated companies was then or in fact until 1927 made by plaintiff. In 1927 claim for refund of taxes overpaid in 1925, because these net losses were not taken into account in the return and the assessment for that year, was made. The claim was rejected on the ground that the statutory net loss deduction was personal to the taxpayer which had sustained it and could be used only in computing its net income. That since neither association had net income in 1925, but in that year, as in 1924, each had sustained a net loss, it could not be availed of by any other of the affiliates having net income to diminish the net income of the group. The District Judge took the same view. Planters Cotton Oil Co. vs. Hopkins, 47 Fed. (2d) 659. This appeal has resulted.

In Woolford Realty Company vs. Rose, decided November 13th, this Court had occasion to consider generally the question here involved. There after full consideration we decided that the statutory net loss deduction was personal to the taxpayer sustaining it, could be availed of in the following year by that taxpayer alone, and by him only to the extent that he had net income in that year. That it could not be availed of to create a minus net income or loss which might be used by a member of the group which did have net income as a positive deduction against that income. [fol. 49] Were this a case as that one was, of corporate affiliation of interests theretofore distinct, brought about after the net losses had been sustained, we should dispose of this case by a mere reference to that opinion. Since, however, the differentiating facts appear here as they did in the case of National Slag Co. vs. Com'r., 47 Fed. (2d) 846, that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies, in the Slag case two companies so owned having been consolidated, in this case five companies so owned having been created by carving three out of the two which had sustained the net loss, it becomes necessary for us now to determine whether these differences of fact require a different legal conclusion. We do not think they do.

It is true that the facts of this case and of the National Slag Company case do present a situation of which if the matter were to be determined upon considerations of general fitness, it might be well said, as the Court did in the Slag case, "It seems on principle that the provisions of Sec. 206 should apply to the consolidated return of these affiliated companies"; but the question may not be decided upon such considerations. The rights of the claimants here must rest upon the express terms of the statute. They have no natural spring. "A deduction from gross income can be claimed only as authorized by the statute." Pugh vs. Com'r, 49 Fed. (2d) 76; Darby Lynde Co. vs. Com'r, 51 Fed. (2d) 32. The statutory net loss deduction has been definitely decided to be a deduction purely personal to the individual taxpayer sustaining it. Busch vs. Com'r, 50 Fed. (2d) 800; First National Bank of Chicago vs. U. S., 283 U. S. 142; Woolford Realty Co. vs. Rose, supra.

Unless therefore the fact that Chapman is and has at all times been substantially the sole owner of the stock both of the unincorporated associations from which the corporate taxpayers sprang and of the corporations gives him warrant to assert that in reality he has at all times been the [fol. 50] taxpayer, and the losses and gains alike have been his, the deduction may not be allowed.

It is the general rule that the corporation and the stockholders are essentially distinct entities, and though to circumvent fraud the corporate entity may be regarded as a fiction, ordinarily it must be regarded as having a real, a substantial existence. Donald vs. Herring-Hall, 208 U. S. 267; Klein vs. Bd. of Supervisors, 282 U. S. 19. Nor does the fact that one person owns all or substantially all of the stock of the corporation at all change the rule. Aiello vs. Crampton, 201 Fed. 891; Ga. Ry. Co. vs. Georgia, 289 Fed. 878; Winfield vs. Wichita, 267 Fed. 47. Particularly is it true as regards taxation and matters of Government fisc, that the members of a corporation and the corporation itself are essentially different entities. Darby Lynde Co. vs. Com'r, 51 Fed. (2d) 32; Marr vs. U. S., 268 U. S. 536; Klein vs. Bd. of Supervisors, 282 U. S. 19. The whole structure of the federal taxing system is based upon a recognition of and an exact compliance with these distinctions Fraudulent pretense absent, the Government accepts the taxpayer as it represents itself to be and one may not, chameleonlike,

change that appearance to suit his necessity or his convenience. Especially may he not, as here, for the purpose of obtaining a deduction which he could have had if the matter had taken individual form, deny that substance to these entities which in the conduct of the business, the making of the tax returns, and in all other respects he at all times has consistently and definitely affirmed.

Though, then, it is true in a sense as the District Judge said it was, that "the result of the year's work was a benefit or a loss to Chapman and the tax was in reality paid by him because he owned the companies", this is not the kind of reality of which he may avail. It is but an ultimate reality, the result of direct, of immediate realities, the operation of corporations which though created by him from the assets of unincorporated associations which he owned, [fol. 51] are none the less in law separate and distinct from each other and from him, with whom, and not with him, the Government has dealt and must continue to deal. The judgment of the Court below is affirmed.

[fol. 52] IN UNITED STATES CIRCUIT COURT OF APPEALS

No. 6243

PLANTERS COTTON OIL COMPANY, INC., Waxahachie, Texas, et al.,

versus

GEORGE C. HOPKINS, Collector of Internal Revenue

JUDGMENT—November 20, 1931

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Texas, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

[fol. 53] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 54] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed March 21, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted, and the case is assigned for argument immediately following case No. 582, Woolford Realty Company, Inc. vs. J. T. Rose, Collector of Internal Revenue, etc.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 36,486. U. S. Circuit Court of Appeals, Fifth Circuit. Term No. 672. Planters Cotton Oil Company, Inc., of Waxahachie, Texas, et al., petitioners, vs. George C. Hopkins, Collector of Internal Revenue for the Second District of Texas. Petition for a writ of certiorari and exhibit thereto. Filed February 1, 1932. File No. 36,486.

FILE COPY

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CHARLES ELMORE C

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1931

No. 672

PLANTERS COTTON OIL COMPANY, INC., OF WAXAHACHIE, ET AL., PETITIONERS,

vs.

GEORGE C. HOPKINS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF TEXAS.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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(36,486)

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1931.

No. 672

PLANTERS COTTON OIL COMPANY, INC., OF WAXAHACHIE, ET AL., PETITIONERS,

vs.

GEORGE C. HOPKINS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF TEXAS.

PETITION FOR WRIT OF CERTIORARI.

MAY IT PLEASE THE COURT:

Summary Statement of the Matters Involved.

A.

The petition of Planters Cotton Oil Company, Inc., Waxahachie, Planters Cotton Oil Company, Inc., Ennis, Planters Cotton Oil Company, of Waxahachie, Planters Cotton Oil Company, of Ennis, and Farmers Gins, Inc., shows to this Honorable Court:

This case was tried in the District Court, Northern District of Texas, upon stipulated facts. Although the stipulation provided that either party could introduce other evidence, not in conflict with the stipulation, no other evidence was introduced (Record pp. 12 *et seq*). The facts are therefore not in dispute. It is admitted and agreed that the Planters Cotton Oil Company, Waxahachie, Texas, and Planters Cotton Oil Company, Ennis, Texas, joint stock associations, were, during the fiscal year ending June 30, 1924, affiliated associations taxable as corporations within the meaning of the Internal Revenue Act of the United States, and that for said year they actually filed a consolidated corporation tax return with the Collector of Internal Revenue, Second District of Texas; that of the 1,500 outstanding shares of the Waxahachie Company, H. N. Chapman owned 1,457, and of the 2,500 outstanding shares in the Ennis Company, H. N. Chapman owned 2,457. It was further agreed that for the fiscal year ending June 30, 1924, the Waxahachie Company sustained a net loss of $182,284.86 and the Ennis Company sustained a net loss of $23,746.17, making a total of $206,031.03, as was shown in said return (Sec. 3 of the Stipulation, R. pp. 14-15).

It was further agreed that on August 18, 1924, the petitioners, Planters Cotton Oil Company, *Inc.*, of Waxahachie, and the Planters Cotton Oil Company, *Inc.*, of Ennis, were each incorporated, the Waxahachie Company having a capital stock of $200,000.00 and the Ennis Company having a capital stock of $300,000.00, each of which was divided into shares of

the par or face value of $100.00, and of which H. N. Chapman owned 1,940 out of 2,000 shares in the Waxahachie Company, Inc., and 2,940 out of 3,000 shares in the Ennis Company, *Inc.* That on the 6th day of September, 1924, the Farmers Gins, Inc., was duly incorporated with a capital stock of $125,000.00, divided into 1,250 shares of the par value of $100.00 each, and that of said shares H. N. Chapman owned 1,204; that each of the three corporations was incorporated under the laws of the State of Texas; that their capital stock was fully paid up and the stock therein issued in consideration of the transfer of certain assets to them, respectively, by the Planters Cotton Oil Company, of Waxahachie, and the Planters Cotton Oil Company, of Ennis, the above mentioned joint stock associations, which transferred assets constituted the entire assets of said new corporations (Secs. 3, 4, 5 and 6, pp. 14-16 of the Record).

After the incorporation of Planters Cotton Oil Company, *Inc.*, of Waxahachie, the Planters Cotton Oil Company, *Inc.*, of Ennis, and the Farmers Gins, Inc., there were then five affiliated corporations, as follows: Planters Cotton Oil Company, Waxahachie, Planters Cotton Oil Company, Ennis, Planters Cotton Oil Company, *Inc.*, Waxahachie, Planters Cotton Oil Company, *Inc.*, Ennis, and Farmers Gins, Inc., and the aforesaid two joint stock associations and three corporations were affiliated corporations within the meaning of the Internal Revenue Act of the United States (Sec. 7 of the Stipulation, p. 16 of the Record), in that H. N. Chapman owned more than 95 per cent of all of the

stock in each of said joint stock associations and said corporations (pp. 14 and 16 of the Record).

It was further agreed that for the fiscal year ending June 30, 1925, said affiliated group, consisting of the five companies aforesaid, were entitled to, and did, file a consolidated income tax return for said period, and that, as disclosed by said return, they sustained a net income for the fiscal year ending June 30, 1925, of $69,237.00. That the following members of said affiliated group realized a net income as follows:

Planters Cotton Oil Company, Inc., Waxahachie	$52,981.25
Planters Cotton Oil Company, Inc., Ennis	79,476.21
Farmers Gins, Inc.	15,178.79
Total	$147,636.25

That the following members of said affiliated group realized a net loss as follows:

Planters Cotton Oil Company, Waxahachie	$72,699.65
Planters Cotton Oil Company, Ennis	5,699.60
Total	$78,399.25

That an income tax was assessed upon said net income of the group in the sum of $8,827.72, and the same was paid to the defendant by the Planters Cotton Oil Company, Inc., for and upon behalf of itself and the other petitioners herein, together with the additional amount of $54.80 interest (Record, p. 17). It was further stipulated that no part of said amount had been refunded.

Petitioners asserted in the courts below that the losses sustained by the two associations for the fiscal taxable year ending June 30, 1924, as above set out, should be allowed as deductions in computing their respective net incomes for the fiscal taxable year ending June 30, 1925, and that such net income when so computed should be reflected in the aggregate of the group. It is admitted that the losses of the two associations for 1924 were in excess of the net income of the group for 1925, when computed without taking the 1924 loss into consideration. The Commissioner refused to allow such claimed deductions on the ground that the companies that sustained the losses in 1924 also sustained losses in 1925.

Judgment was rendered against Petitioners in the trial court, 47 Federal (2) 659. Its judgment was affirmed by the Circuit Court of Appeals, Fifth Circuit. In its opinion, the Circuit Court of Appeals decided two questions of law adverse to the contention of Petitioners; the first of which was decided by it in the case of *Woolford Realty Co., Inc.*, v. *Rose, Collector*, and, in the instant case, its ruling on that question in the Woolford case is merely referred to. It becomes necessary, therefore, to refer to that decision as it was applied in this case.

First Issue.

In the *Woolford case*, the Court itself states the issue to be:

> "* * * Whether the words 'net income' used in Section 206-*b* may mean 'minus net in-

come', or loss, so as to permit a statutory net loss to be availed of by the affiliated group, not merely to the extent of reducing the amount of the corporation entitled to it on which the affiliated group must pay taxes, but of producing a loss or a minus quantity which the affiliated group may use as a deduction from the net income of the member."

Determining the issue, the Court says:

"That the statutory net loss deduction was personal to the tax payer sustaining it and could be availed of in the following year by that tax payer alone and by him only to the extent that he had net income in that year."

Second Issue.

It was the contention of Petitioners that even if the Court's determination of the First Issue was correct as applied to the facts in the *Woolford case,* it was inapplicable to the facts in the instant case, in that one person, H. N. Chapman, at all times owned substantially all the stock in the five companies; that there was not, in 1925, corporate affiliation of interest distinct in 1924, as there was in the *Woolford case,* and that the entire tax ultimately fell on H. N. Chapman.

The Court, in recognizing this distinction, says:

"In *Woolford Realty Company* v. *Rose,* decided November 13th, this Court had occasion to consider generally the question herein involved. There after full consideration we decided that the statutory net loss deduction was personal to the tax payer sustaining it, could be availed of in the following year by that tax payer alone, and by him only to the extent that he had net income in that year. That it could not be availed

of to create a minus net income or loss which might be used by a member of the group which did have net income as a positive deduction against that income.

"Were this a case as that one was, of corporate affiliation of interests theretofore distinct, brought about after the net losses had been sustained, we should dispose of this case by a mere reference to that opinion. Since, however, the differentiating facts appear here as they did in the case of *National Slag Co.* v. *Com'r,* 47 Federal (2) 846, that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies, in the *Slag case* two companies so owned having been consolidated, in this case five companies so owned having been created by carving three out of the two which had sustained the net loss, it becomes necessary for us now to determine whether these differences of fact require a different legal conclusion. We do not think they do."

As is apparent from the above quotation, the Court of Circuit Appeals recognized that this case did not present one of "corporate affiliation of interest theretofore distinct, brought about after the net losses had been sustained," but that "differentiating facts appear here as they did in the case of *National Slag Co.* v. *Commissioner,* 47 Federal (2) 846, that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies". But whether or not "these dif-

ferences of fact require a different legal conclusion" to that reached in the *Woolford case*, the Court says:

"We do not think they do."

B.

Reasons Relied on for the Allowance of the Writ.

The Circuit Court of Appeals held:

First.

(*a*) That the statutory "net loss" incurred by a corporation one year was personal to the tax payer and may be used as a deduction in computing its net income for the second year, under Section 206-*b*, by that tax payer alone, and by him only to the extent that he has a net income for the second year.

(*b*) That a statutory net loss accruing to a corporation when unaffiliated with any other corporation may not be used by it in a subsequent year when affiliated with another, in computing, not simply its own income, but the income of the other members of the group, and the fact that a single individual may at all times own over 95 per cent of each corporation of the affiliated group, and that the tax will ultimately fall on him; and that the creation of the new corporations constituted a mere paper change did not alter the rule.

These conclusions decide most important legal questions—questions that have not been decided and settled by this Honorable Court. That the questions herein presented are of importance not only to Petitioners but to a large number of tax payers throughout the country cannot be doubted. Not only have numerous decisions been handed down, many in conflict with the holding of the Circuit Court of Appeals in

the instant case (as will hereinafter appear), but doubtless many cases involving the same questions are now pending in the Courts as well as before the Board of Tax Appeals. The questions determined by the Circuit Court of Appeals and here presented have frequently arisen in the past, and the making of income tax returns in the future, in similar cases, will and must be determined by the final holding in this case.

We submit, therefore, that it is most important, not only that the conflicts in judicial construction be reconciled, but that the uncertainty that exists, and the importance generally, in regard to this question be definitely and finally determined by this Court.

Second.

The decision in this case, in so far as it construes the language used in Section 206-*b*, reading as follows:

> "Shall be allowed as a deduction in computing the net income of the tax payer for the succeeding taxable year (hereinafter in this section called 'second year'),"

is in direct conflict with the following Circuit Court decisions:

National Slag Co. v. *Commissioner,* 47 Federal (2) 846, Court of Appeals, Third Circuit;

Burnett, Commissioner, v. *Moore Cotton Mills,* 49 Federal (2) 59, Court of Appeals, Fourth Circuit.

It is also in conflict with the following decisions of the Board of Tax Appeals:

Alabama By-Products Corporation, 18 B. T. A. 919.

Ginsburg Company, 19 B. T. A. 81.

Buckie Printers Ink Co., 19 B. T. A. 943.
Pittsburg Gasoline Co., 21 B. T. A. 297.
General Box Corporation, 22 B. T. A. 725.
Arrow Coal & Ice Co., 22 B. T. A. 1341.
Tollerton & Warfield Company, 23 B. T. A. 892.
Hawley Investment Company, 23 B. T. A. 953.
Small's Inc., 24 B. T. A. 686.
Abelson Realty Company, Inc., 24 B. T. A. 686.
Summerfield Company, 24 B. T. A. 829.

Third.

The holding in this case as follows:

> "Since, however, the differentiating facts appear here as they did in the case of *National Slag Co.* v. *Commissioner*, 47 Federal (2) 846, that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and that the tax ultimately fell on him because he at all times owned all of the companies, in the *Slag case*, two companies so owned having been consolidated, in this case five companies so owned having been created out of the two which had sustained the net loss, it becomes necessary for us now to determine whether these differences of fact require a different legal conclusion. We do not think they do;"

is in direct conflict with the decisions of the United States Circuit Court of Appeals in the case therein referred to, *National Slag Company* v. *Commisisoner*, 47 Federal (2) 846 (Third Circuit); *Western Maryland Railroad* v. *Commissioner*, 33 Federal (2) 695 (Fourth Circuit); *Jackson* v. *M. H. Thomas Inv. Co.*,

46 Federal (2) 252, by the Fifth Circuit; and of the decisions of the Honorable Court in *Chicago, Milwaukee & St. Paul Ry. Co.* v. *Minneapolis Civic Association,* 247 U. S. 490, 38 Sup. Ct. Rep. 553, 557; 62 Law Ed. 1229; *Southern Pacific Company* v. *Lowe,* 247 U. S. 330; 38 Sup. Ct. Rep. 540; 62 Law Ed. 1142; *Gulf Oil Corporation* v. *Lewellyn,* 248 U. S. 71, 39 Sup. Ct. Rep. 35; 63 Law Ed. 133.

Fourth.

The Circuit Court of Appeals disregarded the rule of construction of tax statutes, announced by this Court, as follows:

(*a*) That such statutes are strictly construed against the taxing power;

(*b*) That such statutes cannot be extended by implication;

(*c*) Ambiguity in a tax statute should be resolved in favor of the taxpayer.*

WHEREFORE your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals, for the Fifth Circuit, commanding that court to certify and send to this Court,

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* *Burnett* v. *Moore Cotton Mills* (C. C. A., 4th Cir.), 49 Fed. (2) 59, 61, and U. S. Supreme Court cases there cited, as follows:

Gould v. *Gould,* 245 U. S. 151, 62 L. Ed. 211.
U. S. v. *Merriam,* 263 U. S. 179, 68 L. Ed. 240.
Reinecke v. *Trust Co.,* 278 U. S. 339, 73 L. Ed. 410.

on a day certain to be therein designated, a full and complete transcript of the record and of all proceedings in the said Circuit Court of Appeals, in the case entitled: Planters Cotton Oil Company, Inc., Waxahachie, Texas, et al., Appellants, *vs.* George C. Hopkins, Collector of Internal Revenue, Appellee, No. 6243, and that the said decree of the United States Circuit Court of Apepals, for the Fifth Circuit, may be reversed by this Honorable Court, and that your Petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your Petitioners will ever pray.

PLANTERS COTTON OIL COMPANY, INC., WAXAHACHIE,
PLANTERS COTTON OIL COMPANY, INC., ENNIS,
PLANTERS COTTON OIL COMPANY, WAXAHACHIE,
PLANTERS COTTON OIL COMPANY, ENNIS,
FARMERS' GINS, INC.,
By JOE A. WORSHAM,
Dallas, Texas,
J. M. BURFORD,
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Dallas, Texas,
Of Counsel.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1931.

No. 672

PLANTERS COTTON OIL COMPANY, INC., WAXAHACHIE, TEXAS, ET AL., PETITIONERS,

vs.

GEORGE C. HOPKINS, COLLECTOR OF INTERNAL REVENUE, RESPONDENT.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinions of the Courts Below.

The opinion of the District Court is reported in the 47 Federal (2) 659. The opinion of the Circuit Court of Appeals rendered on the 20th day of November, 1931, has not yet been printed in the Federal Reporter, but appears in the Record at pages 47 to 51, inclusive.

The decision of the Circuit Court of Appeals in the instant case, in so far as the construction of the ap-

plicable statutes is concerned (particularly Sec. 206 (*b*) of the Internal Revenue Act of Congress, 1926), is based by mere reference upon its decision in the case of *Woolford Realty Company* v. *Rose, Commissioner*, in which case application for writ of certiorari has been made to this Court, Cause No. 582.* The decision in the *Woolford case* has not been officially reported, but it is found in the record in said Cause No. 582, pages 17 to 24, inclusive.

Jurisdiction.

1. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended, United States Code, Title 28, Sec. 347.

2. The date of the judgment to be reviewed is November 20, 1931 (Record 52).

II.

Statement of the Case.

A full statement of the case is given under heading "A" in the foregoing petition, and, in the interest of brevity, the same is here referred to and made a part hereof without repetition.

III.

Specification of Errors.

1. The Circuit Court of Appeals erred in finding and holding that a statutory "net loss" (within the

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* The application in the *Woolford case* was granted January 25, 1932.

meaning of Sec. 206 (*b*) of the Revenue Act of 1926) incurred by a corporation in one year (the fiscal taxable year ending June 30, 1924), when not affiliated, may not be used to reduce consolidated net income (within the meaning of Section 240 of the Revenue Act, 1926) of an affiliated group, of which such corporation is a member, in a subsequent year (the fiscal taxable year ending June 30, 1925) in which the corporation which has sustained the "net loss" does not have gross income in excess of the deductions allowed by Section 234 (*a*) of the Revenue Act of 1926.

2. The Circuit Court of Appeals erred in holding that

(*a*) The fact that one person owns all or substantially all of the stock of the corporation at all times does not change the rule announced by the Court set out in Paragraph 1 above.

(*b*) The fact that the tax ultimately fell on one individual, who was the owner at all times of substantially all the stock in all of the corporations involved, the five companies so owned having been created by carving three out of the two which had sustained the let loss, did not alter the general rule announced by the Court as applicable, and as set out in Paragraph 1 above.

3. The Circuit Court of Appeals erred in affirming the judgment of the District Court of the Northern District of Texas wherein judgment was rendered against petitioners and in favor of Respondent.

ARGUMENT.

The Circuit Court of Appeals in this case has decided important questions of Federal Law which have not been, but should be, settled by this Court.*

(*a*). The first reason for the allowance of the Writ in the petition shows the question involved and the importance of a decision by this Court. (See Sec. *a* of said Petition, page 8.) The statement of that reason is not repeated here. While no attempt is made in this brief to present a thorough argument on the merits of petitioner's contention, a brief analysis of the pertinent statutory provisions is made for the purpose of presenting clearly the question involved and the importance of a decision thereon by this Court.

The question in this case involves the determination of consolidated net income. We discuss, first, the provisions for the determination of the net income of a single tax payer.†

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*The argument appearing in the brief of Mr. W. A. Sutherland, at Atlanta, in support of the Petition for Writ of Certiorari, in the case of *Woolford Realty Company, Inc.*, v. *Rose, Commissioner*, Cause No. 582, filed in this Court, is, with his permission, here adopted as sub-section (*a*) hereof.

† * * * Throughout this brief, reference to Section and Article relate to Sections of the Revenue Act of 1926, and Articles of Regulation 69, unless otherwise indicated. (It may be added here that if there is doubt as to whether this case is controlled by the Act of 1924 or 1926, Sec. 206-*b* is identical in the two Acts, and that the defendant has contended throughout the litigation that the Act of 1926 applies.)

Section 232 provides:

> "SECTION 232. In the case of a corporation subject to the tax imposed by Section 230 the term 'net income' means the gross income as defined by Section 233, less the deduction allowed by Sections 234 and 206 * * *."

Section 234 (*a*) provides:

> "SECTION 234 (*a*). In computing the net income of a corporation subject to the tax imposed by Section 230, there shall be allowed as deductions: * * *"

(There are then listed, under sub-paragraphs (1) to (11), all deductions permitted in determining net income except *"net losses"* brought forward from preceding years, which is covered by Section 206.)

Section 206-*a* provides for the determination according to peculiar statutory provisions of what that Section designates as a "net loss". That the "net loss" defined in Section 206-*a* is a statutory concept and not to be confused with *loss* in general, is made clear by Article 1621 of the Regulations, which provides:

> "Article 1621. * * * The amount properly allowed (as a 'net loss') may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to statute * * *."

Section 206-*b*, with reference to the deductions of these statutory "net losses" from gross income in succeeding years, provides:

"SECTION 206-*b*. If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this Section called 'second year'), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this Section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

Section 240-*b*, covering cases where corporations are affiliated and a consolidated return is filed, provides:

"SECTION 240-*b*. * * * the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in the proportions provided. * * *"

Article 635 of Regulations 69, promulgated under Section 240, eliminates intercompany transactions, and provides:

"ARTICLE 635. Subject to the provisions covering the determination of taxable net income of separate corporations, * * * the consolidated taxable net income shall be the combined net income of the several corporations consolidated * * *."

A mere reading of the provisions of the statute and regulations with reference to the determination of con-

solidated net income would seem to make it too clear for argument that the net income of a consolidated group is to be computed by taking the aggregate of the gross income of each member of the group and subtracting from this aggregate gross income the aggregate of all the deductions provided for each member of the group. Article 31 (*a*) of Regulations 75, promulgated under substantially similar provisions of the Revenue Act of 1928, expressly provides that consolidated net income is to be determined in this manner.*

The Circuit Court of Appeals has recognized the propriety of subtracting from the aggregate gross income of the five corporations all of the deductions allowable to each of the members of the group by Section 234 (*a*), notwithstanding the fact that the aggregate of the deductions allowed on account of the Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, by Section 234 (*a*) was in excess of their respective gross income. But the Court has denied the propriety under such circumstances of deducting from gross income the "net

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*"Reg. 75, Art. 31 (*a*). *Definition.*—Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as 'intercompany transactions')." (Cf. Rev. Act. 1928, Sec. 141.)

loss'' deductions of those companies, respectively, allowed by Section 206 (*b*). There is no basis whatever for making any distinction in a consolidated return between the deductions allowed by Section 234 (*a*) and those allowed by Section 206 (*b*). If the former deductions are permitted when in excess of the gross income of the separate corporation sustaining same, the latter must likewise be allowed.

From the opinion as a whole, it seems that the Court reaches its decision adverse to petitioners' contention upon the theory that the construction for which petitioners contend would accomplish an inequitable result and a result ''generally inappropriate to the Federal scheme of income taxation designed as it is *with the sole exception of the statutory net loss provision* to make each person subject to the tax pay taxes on his income for the year in which it accrues.'' (Italics ours.) This brief does not permit a full analysis of the error of this view. The fallacy of the assumption upon which this holding is based is clearly established by the fact that in Article 41 (*c*) of Regulations 75, promulgated under substantially similar provisions of the Revenue Act of 1928, the Commissioner and Secretary of the Treasury expressly permit the deduction which petitioners here contend is allowable.*

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* ''Art. 41 (*c*). *Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.*—A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss prior to the taxable year 1929) shall be allowed as a

The language in some portions of the opinion of the Circuit Court of Appeals seems to indicate that the Court assumes that the literal language of Section 206 (*b*), to the effect that the net loss deduction is to be allowed in the succeeding year in computing "the net income of the taxpayer" (Italics ours), requires that this deduction be limited to the individual taxpayer which sustained the loss. It could be argued with as much reason that the ordinary deductions allowable under Section 234 (*a*) cannot be used in the computation of consolidated net income because Section 234 (*a*) provides that "in computing the net income of *a corporation* subject to the tax imposed by Section 230, there shall be allowed as deductions" (Italics ours) the items there listed. The argument that the literal words of either section do not provide for the allowance of these deductions in the computation of consolidated net income would be clearly erroneous. Of course, Sections 234 (*a*) and 206 (*b*) refer to single taxpayers. But Article 635, promulgated under Section 240, which provides that the net income of the consolidated group shall be "the combined net income of the several corporations consoli-

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deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated net income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

dated", necessarily means that all the items of gross income and all the deductions of the individual taxpayer must be taken into account. Otherwise it means nothing, and leaves to the Commissioner's caprice in each individual case, or to the individual opinion of whatever court happens to be considering the matter, the determination of what, and under what circumstances, deductions are or are not allowable in a consolidated return. Section 240 and Article 635 expressly provide for the extension and enlargement of the provisions of the Act relating to gross income and deductions of single taxpayers to make them applicable to an affiliated group. They do not leave to the Commissioner any more latitude in saying which of the particular deductions granted by statute shall be allowed to the consolidated group than they leave the Commissioner or a court to say what deductions shall be permitted to a single taxpayer.

In other portions of the opinion it is intimated that the petitioners' contention requires the concept of "net income" as a minus quantity. Such is not the case if the provisions of Article 635 are interpreted, as we interpret them, as providing for the computation of consolidated net income by deducting from the aggregate of the gross income of the several corporations the aggregate of the deductions allowable under Sections 234 (*a*) and 206 (*b*). If, however, Article 635 is taken to require the computation of net income for each separate corporation and then the combination of these separate net incomes, the concept of a net income as a minus quantity is necessary. "Net income", as

used in the Act, *is a creature of statute* and is fully defined in Section 232. We find no difficulty in admitting the concept of net income as a minus quantity. It will always be a minus quantity when the deductions allowable by Section 234 (*a*) or Section 206 (*b*), or both combined, exceed gross income as defined in Section 233. In this case, the Commissioner himself has allowed a minus figure (which, upon his theory, must be *minus net income*) for both the Planters Cotton Oil Company of Waxahachie and the Planters Cotton Oil Company of Ennis, to be combined with the net income of the three corporations in arriving at the consolidated net income. The Court and Commissioner have refused to permit these minus figures to be increased by the deduction allowable under Section 206 (*b*).

(*b*) The Circuit Court of Appeals, as pointed out in Section (*b*) of the Reasons Relied upon for the Granting of the Writ, Application for Writ of Certiorari (p. 8), held not only that a statutory net loss accruing to a corporation when unaffiliated with any other corporation may not be used by it in a subsequent year when affiliated with another, in computing, not only its own income, but the income of the other members of the group (following its own decision in the *Woolford case*); *but further held that the fact that a single individual may at all times own substantially all of the stock in each of the corporations composing the group, that the tax will ultimately fall upon such individual, and that the creation of the additional corporations constituted a mere paper change, was wholly immaterial in the application of its announced rule.*

It is submitted that this additional holding of the Circuit Court of Appeals, in the instant case, likewise decides an important question of Federal law which has not, but should be, settled by this Court.

As has already been shown, on June 30, 1924, the end of the fiscal taxable year, there were then in existence only two of the taxpayers, Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, which were affiliated; that H. N. Chapman owned over 95 per cent, or substantially all, of the stock in each. That during the fiscal taxable year ending June 30, 1925, three additional corporate taxpayers, Planters Cotton Oil Company, *Inc.*, of Waxahachie, Planters Cotton Oil Company, *Inc.*, of Ennis, and Farmers Gins, Inc., were carved out of the original two, and that H. N. Chapman owned over 95 per cent, or practically all, of the capital stock of each of the new companies. It was agreed that at the end of the fiscal taxable year, June 30, 1925, there were then five members of the affiliated group, whereas, there were only two the year before, but that the five owned identically the same assets as did the original two, as the entire corporate property of the three consisted of assets transferred to them, respectively, by the two original members (Record, pp. 3, 4, 5).

The Circuit Court of Appeals, in its opinion, says:

> "* * * that one person has at all times been substantially the owner of all of the stock in all the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies, in the *Slag case* two companies so owned, having been consolidated, in this case

five companies so owned, having been created by carving three out of the two which has sustained the net loss."

The Court then adds that it becomes necessary to consider whether or not this fact leads to a different conclusion to that reached in the *Woolford case,* and, in answer to the question, says that "we do not think they do."

Further quoting the findings from the Circuit Court's opinion:

> "Unless therefore the fact that Chapman is and has at all times been substantially the sole owner of stock of both the unincorporated associations from which the corporate tax payers sprang, and of the corporations, gives him warrant to assert that in reality he has at all times been the tax payer, and the losses and gains have been his, the deduction may not be allowed."

The net losses and net income of the corporate group for the fiscal taxable years ending June 30, 1924, and June 30, 1925, were as follows:

	1924	1925
Planters Cotton Oil Company, Waxahachie	$182,284.86 (loss)	$72,699.65 (loss)
Planters Cotton Oil Company, Ennis	23,746.86 (loss)	5,699.60 (loss)
Planters Cotton Oil Co., Inc., Waxahachie		52,981.25 (net income)
Planters Cotton Oil Co., Inc., Ennis		79,476.21 (net income)
Farmers Gins, Inc.,		15,178.79 (net income)
Total Net Loss	$206,031.03	
Net income of the group for the year 1925, without taking into consideration the 1924 loss, amounted to		$69,237.00

(Record, pp. 4 and 5.) This is the amount upon which the tax sued for herein was paid. It is readily apparent that if the loss sustained by the two affiliated associations in 1924 had been allowed as a deduction, amounting to the sum of $206,031.03, there would have been no net income for the year 1925, but, on the contrary, a net loss by the group of $136,794.03. It is further evident and apparent that, if there had not been a carving out of the two original companies, of the three new ones, the consolidated net loss of the two old companies would have been the sum of $136,794.03, and that no tax would have been levied or paid. The tax levied and paid for the year 1925 was just as surely a tax levied on H. N. Chapman, in so far as result was concerned, as if he had conducted the business as an individual, or there had been only one company. The Circuit Court of Appeals admits that the tax "ultimately fell on him." The fact is that Chapman has paid practically $9,000.00 taxes upon an income that did not exist.

In its opinion in the case of *Woolford Realty Company* v. *Rose*, the Circuit Court of Appeals says:

> "While appellant does find support for the position which it takes in the opinions of the Tax Board, we cannot agree with the view which the Board takes. Whether the decision in the *National Slag case, supra,* was or not correct, it did not decide the point before us. That case merely decided that since one Buckland had, during the years in which the statutory net losses were sustained, as well as during the years of affiliation, owned both of the enter-

> prises, the loss was really his loss, and the statute should be construed so as to give him the benefit of it."

The decision in the *Slag case* was rendered by the Circuit Court of Appeals, Third Circuit, 47 Federal (2) 846. The Circuit Court of Appeals, in the instant case, expressly admitted that the facts in this case and in the *Slag case* were parallel, or on "all fours," in that (further quoting from the text of the opinion),

> "Since, however, the differentiating facts appear here as they did in the case of *National Slag Company* v. *Commissioner,* 47 Federal (2) 846, that one person has been at all times substantially the owner of all the stock in all the companies involved and the tax ultimately fell on him, because he, at all times, owned all the companies, in the *Slag case* the two companies having been consolidated, in this case five companies so owned having been created by carving three out of the two which had sustained the let loss * * *."

The facts in the *Slag case* showed that one Buckland owned in one of the companies 9,998 shares out of 10,000, and 3,296 out of 3,000 shares outstanding in the other. After referring to the applicable statutes, the Court, in the *Slag case,* says:

> "These sections make it perfectly plain that if the tax payer in the case at bar had been an individual, he would have had the right to deduct the losses for 1922 and 1923 from his 1924 tax return";

and further:

> "In view of the fact that Buckland owned both companies before and after incorporation of the Slag Company, it seems on principle that the provisions of Section 206 should apply to the consolidated return of the affiliated companies."

The Circuit Court of Appeals, Fifth Circuit, in this case, came to an entirely different conclusion to that reached by the Circuit Court of Appeals, Third Circuit, in the *Slag case* upon a similar state of facts, and we respectfully submit that the conclusion reached in the *Slag case* is correct. The Circuit Court of Appeals, in the instant case, admits:

> "That the facts in this case present a situation of which, if the matter were to be singly determined upon considerations of general fitness, it might well be said, as the Court did in the *Slag case*, 'it seems on principle that the provisions of Section 206 should apply to the consolidated returns of these affiliated companies,' but the question may not be decided upon such considerations."

The Court then came to the conclusion that while "considerations of general fitness" would be favorable to petitioners, consideration of the law applicable to the facts would lead to a different result.

We respectfully submit that not only is the position of petitioners sustained by "general fitness," but also by the decisions of this Court, as well as various Courts of Circuit Appeals, in addition to the *Slag case*.

In the case of *Southern Pacific Co.* v. *Lowe*, 247 U. S.

330, 38 Sup. Ct. Rep. 540, 62 L. Ed. 1142, suit was filed by the Southern Pacific Company to recover alleged over payment in income taxes. It appeared that the income tax in dispute was represented by certain dividends paid to the Southern Pacific Company by the Central Pacific Railway, whose entire capital stock was owned by the Southern Pacific. The two companies were technically separate identities. Judgment having been rendered against the Southern Pacific in the trial Court, the case was reviewed and reversed by this Court. The Court, in its opinion, says:

> "We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing the entire net income arising or accruing from all sources during each year, commencing the 1st day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; *and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes, they were merged, the former being but a part of the latter acting merely as its agent and subject in all things to its proper direction and control. And besides the funds represented by the dividends were in the actual possession and control of the Southern Pacific as well before as after the declaration of the dividends. The fact that the books were*

> *kept in accordance with the provisions of the lease, so that the funds appeared upon the accounts as an indebtedness of the lessee to the lessor connot be controlling in view of the practical identity of the lessor and lessee.''* (Italics supplied.)

In *Gulf Oil Corporation* v. *Lewellyn* (an income tax case), 248 U. S. 71, 39 Sup. Ct. Rep. 35, 63 Law Ed. 133, the Court uses the following pertinent language:

> "But disregarding the forms gone through, the result was that the petitioner became the holder of the debt previously due from one of its companies to the other. It was no richer than before, but its property now is represented by stock in and debts due from its subsidiaries, whereas formerly it was represented by the stock alone, the change being effected by entries upon the respective companies' books."

In the case of *Western Maryland Ry. Co.* v. *Commissioner,* 33 Federal (2) 695 (C. C. A. Fourth Circuit), the Court uses this language:

> "After all, while there is a technical legal difference between the old and the new corporations, they are the same as a practical matter, both holding the same property and representing the same ownership, and it is a settled principle that 'courts will not permit themselves to be blinded or deceived by mere forms of law, but regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require'."

In the instant case, after three new companies were "carved" out of the original two, *they were no richer; they held the same property; they represented the same ownership.* They were separate in form only; they were the alter ego of H. N. Chapman (see decision by the Fifth Court of Appeals, *Jackson* v. *Thomas Investment Company,* 46 Federal (2) 252); and it is apparent and undeniable that the losses and income would have been identical for the year 1925 if the three new companies had never existed, in which case there undeniably would have been no tax due. The Courts have many times recognized the rule that where there is a practical identity between corporations, their separate legal entities will be disregarded. This rule has been applied to varying facts including tax cases. The only question is, Does it apply in the matter of income taxation? We respectfully submit that if applied in any case, it should apply to such a case, upon the authority of the line of decisions by this Court, of which *Burnett* v. *Niagara Falls Brewing Company,* 282 U. S. 648; 51 Sup. Ct. Rep. 262; 75 Law Ed. 594, is typical, holding that tax laws are to be construed liberally in favor of the taxpayer.

B.

The decision of the Circuit Court of Appeals in this case is in direct and admitted conflict with the decision of another Circuit Court of Appeals on the same matter.

The admitted conflict between the holding of the Court in the instant case and that of the Circuit Court of Appeals, Third Circuit, in the *Slag case,* 47 Federal

(2) 846, has been previously pointed out and reference is here made thereto without repetition.

C.

The Statutes involved herein are clear and unambiguous, and reasonably admits of but the one construction herein insisted upon, but, even if such statutes (as held by the trial court) "are not clear," the rule of construction favorable to the taxpayer should be adopted. This the Circuit Court of Appeals failed to do. The trial court in this case stated in his opinion that "the question is troublesome. The use that may be made of a loss is not clear." Again, after quoting Section 206 (*b*), he says: "Without the words 'computed without such deduction,' the statute would be even less clear * * *"

This Court has held many times that ambiguities in taxing statutes would be construed in favor of the tax payer, and that the rule of strict construction would be applied. The rule is admirably stated in *Burnett, Commissioner,* v. *Moore Cotton Mills,* 49 Federal (2) 59, Circuit Court of Appeals, Fourth Circuit, referring to a statute similar to the one here involved:

> "Also, should we assume ambiguity to exist in the phraseology in construing a tax statute of this kind, any such ambiguity should be construed in favor of the taxpayer,"

citing the following cases decided by this Court:

Gould v. *Gould,* 245 U. S. 151, 38 S. Ct. 53; 62 L. Ed. 211;

U. S. v. *Merriam,* 263 U. S. 179; 44 S. Ct. 69; 69 L. Ed. 240; 29 A. L. R. 1547;

Reinecke v. *Trust Co.,* 278 U. S. 339, 49 S. Ct. 123; 73 L. Ed. 410; 66 A. L. R. 397.

Conclusion.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, in order that the important questions of Federal Law decided below may be finally settled by this Court and that the conflict in the decisions of the Courts of Circuit Appeals may be reconciled, and that to such an end a Writ of Certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals and finally reverse it.

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IN THE

Supreme Court of the United States

October Term, 1931

No. 672

PLANTERS COTTON OIL COMPANY, INC., OF WAXAHACHIE, et al.,

Petitioners,

vs.

GEORGE C. HOPKINS, COLLECTOR INTERNAL REVENUE FOR THE SECOND DISTRICT OF TEXAS

Respondent.

SUPPLEMENTAL BRIEF FOR PETITIONERS

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Petitioners desire merely to file a brief supplementing the one filed herein in support of the Petition. The Statement of the Case, shown on pages 1 to 5 inclusive of the Petition, is here referred to without repetition. Petitioners set out in the Petition what they conceived to be the controlling issues in this case as "First Is-

sue", Petition, page 5, and "Second Issue", Id., page 6. Specifications of the errors complained of are found on pages 14 and 15 of the Brief in Support of the Petition. It is the Petitioners' purpose now merely to supplement the argument contained therein, which will be confined to Specifications of Error numbered 1 and 2.

FIRST SPECIFICATION OF ERROR

> The Circuit Court of Appeals erred in finding and holding that a statutory "net loss (within the meaning of Section 206-b of the Revenue Act of 1926) incurred by a corporation in one year (the fiscal taxable year ending June 30, 1924), when not affiliated, may not be used to reduce consolidated net income (within the meaning of Section 240 of the Revenue Act, 1926) of an affiliated group, of which such corporation is a member, in a subsequent year (the fiscal taxable year ending June 30, 1925) in which the corporation which has sustained the "net loss" does not have gross income in excess of the deductions allowed by Section 234 (a) of the Revenue Act of 1926. (Brief in Support of the Writ, pages 14–15.)

Section 206-b of the Revenue Act is copied on page 18 of Petitioners' original Brief. The phrase to be construed reads as follows: "shall be allowed as a deduction in computing the net income of the tax payer".

It will be noted that the controlling statute provides that, in computing the net income for the second. year, the amount of the net loss sustained by the tax payer during the preceding taxable year *"shall be allowed as a deduction in computing the net income* of the tax payer for the succeeding taxable year", or second year, and it also provides that

> "If such net loss is in excess of such net income (computed without such deduction), the amount of such excess *shall be allowed as a deduction in computing the net income* for the next succeeding taxable year", the third year. (Italics supplied.)

We call the Court's attention to the fact that the phrase *"shall be allowed as a deduction in computing net income"* is identically the same, word for word, for the second year as for the third year. Prior to 1924, the act, as it applied to the second year, did not read as it now does, but for the second year, the following language was used in lieu of the above quoted phrase: "shall be deducted from the net income" of the succeeding or second year. The act of 1924, as applied to the second year, instead of providing as it had theretofore that the net loss for the first year shall "be deducted from net income", was changed so as to read: "shall be allowed as a deduction in computing the net income". It is the contention of the defendant that the two phrases: "shall be deducted from the net income" and "shall be

allowed as a deduction in computing the net income" are identical in meaning, and, even if they are not, the Court will, nevertheless, of necessity (for reasons hereinafter stated) so construe them. This the Petitioners controvert, believing that the Board of Tax Appeals was correct in stating that the two clauses are "fundamentally different".

The case of Moore Cotton Mills vs. Commissioner, 17 BTA, 662, arose under the Act of 1921, which provided that, for the second year, the net loss of the preceeding year "shall be deducted from the net income" of the second year, but that, for the third year, the amount of the excess loss of the second year "shall be allowed as a deduction in computing net income" for the third year. While the case did not involve affiliated corporations, it did involve, and in fact the only thing that was involved was, the meaning of the latter phrase —the very one now in question, word for word, "shall be allowed as a deduction in computing net income". Prior to this decision, the Board of Tax Appeals had held in conformity with the views of the defendant here. The Board points out that it had prior thereto so held but observes that, for the first time,

> "Our attention is directed to the fundamental difference in the provisions of the statute covering 'the succeeding taxable year', and 'the next succeeding taxable year'."

"For the second year, the law provides that such loss shall be deducted from the net income of the tax payer; for the third year the clear and unmistakable language of the Act provides that any excess of the net loss remaining after it has been applied against the net income of the second year 'shall be allowed as a deduction in computing the net income for the next succeeding (third) taxable year."

The Board further held that the regulations of the Commissioner to the contrary were without effect.

"The power of federal legislation lies solely in Congress, and in our opinion that part of the regulation of the Commissioner which we have italicized and which provides that the excess of the net loss over the net income of the second year 'shall be carried over and credited against the net income for the next succeeding (third) taxable year', where Congress has clearly provided that 'the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year', is an erroneous construction of the act and goes beyond the power delegated to the Commissioner."

The Government appealed this case to the Circuit Court of Appeals, 4th Circuit, 49 Federal (2) 59, and the decision of the Board was *affirmed*. The Circuit

Court of Appeals, in its opinion, quotes the pertinent parts of the opinion of the Board, and adds:

> "We believe the above conclusion of the Board and the reasoning upon which it is based to be sound, and feel that little need be added to what the Board has said."

Undoubtedly the Government there argued, as here, against "minus net income", an impossibility, and such a result leading to "absurdity", as the Court adds:

> "But we do not concede that there is in fact any real ambiguity, much less that the result here produced is absured, albeit there may be no sound reason for saying that while net loss shall not be an item in the computation of net income for the first succeeding taxable year it shall be in the computation of net income for the second succeeding year."

The Circuit Court of Appeals for the Third Circuit has also passed upon the question favorable to the contention of Petitioners. This Court, in the case of National Slag Company vs. Commissioner, 47 Federal (2) 846, says:

> "The deductions of the losses here in question, sustained in 1922 and 1923 come directly within the provisions of the statute which are plain, certain and unambiguous."

It also quoted from and approved an opinion rendered by the Board of Tax Appeals in the Alabama By-Products case, 18 BTA 919, as follows:

> "The 1924 Act contains materially different provisions from those of the 1921 Act with respect to the treatment of net losses, in that the 1924 Act provides that a net loss shall be allowed 'as a deduction in computing the net income of the tax payer', for the succeeding taxable year, whereas, the corresponding provision of the 1921 Act requires that a net loss shall in the first instance be allowed as a deduction from net income."

The Alabama By-Products case further used this language:

> "The excess of the net loss of 1919 over the 1918 net income is, by plain language of the statute, put in the same category as any other deduction allowed by statute in determining net income for the taxable year",

the same as interest paid, taxes and other proper deductible expenses or losses. But the defendant, as we understand it, contends that the construction placed upon the phrase in question, while reasonable, is untenable and impossible, because there is and can be no such a thing as a "minus net income", and the Circuit Court of Appeals adopts this view.

We respectfully submit, however, that the Comissioner is now permitting the tax payers to do the very thing that the Circuit Court of Appeals holds to be a physical impossibility. In the case of Burnett vs. Moore Cotton Mills, supra, (decided April 13, 1931), the Court uses this language:

> "Lastly, if further support were needed for the conclusion here adopted, it is to be found in the form in which Section 204 (b) of the Act of 1921 was redrafted in the Act of 1924 (Section 206-b) and carried into each subsequent Act. That redraft is as follows: '(Here Section 206-b is copied in full.)' (43 Stat. 260, and 44 Stat. 17.) (26 USCA Section 937 (b)); Section 117 (b), 45 Stat. 825, (26 USCA Section 2117 (b)).
>
> "As a result of this redrafting, the Treasury Department has redrafted its Regulations and has ever since construed Section 204 (b), as thus amended to allow the net loss to be treated as a deduction, in computing the net income for both the second and third years. See Regulations 65, Article 1622; Regulation 69, Article 1622; Regulation 74, Article 652. Since the amendment incorporated, with respect to the application of the net loss to both the second and third years, the same language that was used in the 1921 Act with respect to the application of the net loss to the third year, and since thereafter the Treasurer Department has applied exclusive-

ly the rule here contended for by the tax payer, the commissioner's present position is at least inconsistent, and without persuasive force."

Again, if there can be no such thing as a "minus net income", this litigation becomes absolutely moot, for in such a case there can be no loss from the first year to be carried forward to the second, and no "excess" from the second to be carried forward to the third. Take two tax payers, both required to and do make out income tax returns, one of whom has sustained a net loss. In making their respective returns, can it be said that they each in so doing "compute their net income"? We think so, but the defendant contends that the one computes his "net income"; the other does not and cannot, but computes his—what? Lack of net income? Net loss? But "net income" of a corporation is defined in the statute. It is defined by Section 984 (USCA), as follows:

"Net income means the gross income as defined in Section 985, less the deductions allowed by Sections 986 and 937 and the net income shall be computed on the same basis as is provided in Subdivisions (b) and (d) of Section 953, or in Section 968."

Now Section 986 (U. S. C. A.) provides:

"In computing the net income of a corporation subject to the tax imposed by Section 981 of this

chapter, there shall be allowed as deductions", (naming ordinary and necessary expenditures in the operation of the business, rentals, salaries, interest and taxes paid, losses sustained, worthless debts, and so forth), while

Section 937 (U. S. C. A.) expressly mentioned in Section 984 as containing other allowable deductions, is Section 206 of the Act, Section (b) thereof being the very one involved here. It is the identical section that authorizes the tax payer who has sustained a net loss for any taxable year to be allowed the amount thereof as a deduction in computing his net income for the next succeeding taxable year.

In the Woolford case, companion case to the one at bar, 53 Federal (2) 821, the Court looks upon the deductions provided in Section 986 as kind of usual and ordinary deductions, and those provided in Section 937 as unusual and extraordinary. It says:

> "Of course, if appellant is right in its assumption that the statutory net loss deductions (provided in Section 937) "must be treated like any other deduction" (as provided in Section 986), 'in making up a consolidated return, it is right in its conclusion that it should have had the benefit of it here."

We find no authority or justification for the deductions provided in Section 986, except that it is so pro-

vided in Section 984, and that very same section provides for the deduction set out in 937. Why should they be treated differently, or not be "treated like any other deduction"?

If defendant is correct in his contention that the deductions mentioned in the respective sections should be treated differently and that there cannot be a "minus net income", then the Court would of necessity read Section 984, as follows:

> "Net income means the gross income as defined in Section 985, less the deduction allowed by Section 986, in so far and until such deductions shall equal the gross income after which there shall be no further deductions because there is nothing left from which to deduct it, and there can be no minus net income. But if the gross income exceeds the deductions provided for in Section 986, then the deductions mentioned in Section 937 may be allowed in so far and until such deductions shall equal any balance of the gross income after allowing the deductions provided for by Section 986, after which there shall be no further deductions, because to allow further deductions would result in a minus net income, and this leads to absurdity and impossibility."

By such reasoning, there can never be a loss for any taxable year to carry forward to the next succeeding

taxable year, for the reason that there is no statutory method by which to determine it. In order for the tax payer to ascertain his net loss for any taxable year to be carried forward to the next succeeding taxable year, it is required that he "compute the net income of the corporation", according to the statutory formulas, and, as there can be no minus net income there is no way of ascertaining the loss.

There is not, so far as we know, one statute which provides the formula for the tax payer to use in computing his net income and another and a different one for the use in computing his net loss. The only statutory method provided for the tax payer to ascertain his "net loss" is the formula provided in the statutes herein above set out, which defines "net income"; that is, taking the tax payer's "gross income", as defined, less the statutory deductions as provided, and the difference is the net income. Sadly enough no method was provided by which the tax payer is assured that this difference will always be positive, never negative.

We, therefore, respectfully submit that the deductions authorized by Section 937 (U. S. C. A.) 206-b are to be treated in the same manner, as expressly provided in Section 984, and that the only formula known to the Act by which the net income may be ascertained, is to enter in the return the gross income of the tax payer as provided (Section 985) less the deductions au-

thorized by Section 984, which are those mentioned alike and without distinction, in Sections 937 and 986.

SECOND SPECIFICATION OF ERROR

The Circuit Court of Appeals erred in holding that:

(a) The fact that one person owns all or substantially all the stock of the corporations at all times does not change the rule set out in the First Specification of Error, of which holding error is therein assigned.

(b) The fact that the tax ultimately fell on one individual who was the owner at all times of substantially all the stock in all the companies involved, the five companies so owned having been created by carving three out of the two which had sustained the net loss, did not alter the general rule set out in the First Specification of Error, which holding is therein assigned as error.

The question raised by the Second Specification of Error is plainly stated by the Circuit Court of Appeals, as follows:

"Were this a case as that one was (Woolford Realty Company vs. Rose) of corporate affiliation of interest theretofore distinct, brought about after the net losses had been sustained, we should dispose of this case by a mere reference to that opinion.

> Since, however, the differentiating facts appear here as they did in the case of National Slag Company vs. Commissioner, 47 Federal (2) 846, that one person has at all times been substantially the owner of all the stock in all of the companies involved, and the tax ultimately fell on him because he at all times owned all the companies, in the Slag case two companies so owned having been consolidated, in this case, five companies so owned having been created by carving three out of the two which had sustained the net loss, it becomes necessary for us to determine whether these differences in fact require a different legal conclusion. We do not think they do."

The Circuit Court of Appeals, in deciding that "we do not think they do", came to the very opposite conclusion to that reached by the Circuit Court of Appeals, Third Circuit, in the Slag case, above mentioned. This fact, it concedes, in stating that "the differentiating facts appear here as they did in the case of National Slag Company vs. Commissioner . . ."

The Circuit Court of Appeals in the instant case held, as we understand it, that corporate entity may never be disregarded, except "to circumvent fraud", and particularly should the rule of adhering to corporate entity be adhered to in tax matters.

In support of the proposition that corporations and the stock holders thereof are essentially distinct entities, the Court cites Donnell vs. Herring-Hall, 208 U. S. 267; 28 S. Ct. Rep. 288; 52 Law Ed. 481, and Klein vs. Board of Supervisiors, 282 U. S. 19, 51 S. Ct. 15, 75 Law Ed. 140, 73 ALR 679. The former case deals only with the question of unfair competition in the use of one's own surname, such surname having been used in the name of an incorporated company, while in the latter case, the only question decided was that a statute of Kentucky which provided that share holders in a corporation should render the same for taxation and pay taxes thereupon, except

> "The individual stock holders of a corporation, at least seventy-five per cent (75%) of whose total property is taxable in Kentucky, shall not be required to list their shares for taxation so long as the corporation pays taxes on all its property in Kentucky."

This act was attacked as violative of certain provisions of the Federal Constitution, as constituting double taxation. The Court held that the corporation was a separate entity (following the conceded general rule) and refused to nullify the act as violative of either the equal protection or due process clauses thereof. The Court refused to apply the "fiction doctrine" to the corporation by refusing to declare a state statute un-

constitutional. It did make the following observation, however:

> "If the corporation, having all its property in the state, has paid taxes upon the whole, usually it would be just not to tax the stock holders in respect of value derived from what already has borne its share."

This expression causes no surprise because it simply states what appears right to every fair minded man, and, besides, is in conformity with the Federal policy in regard to double taxation, as announced in the National Bank Act, which *does not* permit the shares of stock and the capital stock both to be taxed.

The Court of Appeals then adds that the fact that one person does own all or substantially all of the stock of the corporation does not change the above announced rule, and cites the following cases in support of the proposition:

Georgia Ry. vs. Georgia, 289 Federal 878;

Winfield vs. Wichita Natural Gas Co., 267 Federal 47;

Aiello vs. Crampton, 201 Federal 891.

In the Georgia Railway case, which arose out of a controversy between the Railway Company and the State Public Service Commission, it appeared that the South-

ern Railway owned 69½% of the stock of the Georgia Railway. The Court said:

> "We think these two corporations are separate and distinct railroad companies, not under one management or operation, and that the traffic relations between the same should be governed by the said rules as pertain between other connecting lines. *To hold otherwise ignores the rights of the minority stockholders.* * * *" (Italics supplied.)

The following excerpt is copied from the decision in the cited case of Winfield vs. Gas Company, supra:

> "Counsel for the city throughout the discussion of this case, have earnestly contended that the court, in the treatment of the parties to it, should ignore the difference between the rights and liabilities of the two defendants, between the rights and liabilities of the alleged sole stockholder of the Winfield Natural Gas Company, the Wichita Company, and the rights and liabilities of the Winfield National Gas Company; that it should disregard the express limitations of the special agency of the Winfield National Gas Company for the Wichita Company created by the Hackney Supply contract, treat the former as the general agent of the latter, empowered to bind it by an agreement of assumption of the obligation of Patterson and his successors, when it had no such authority; and that the

Court should reinstate the injunction on the theory that the parties were in effect one, and that that one ought to discharge the obligation of Patterson and his successor under the ordinary contract. *If equity and justice demanded such a course of action by a court of equity, some of the contentions which counsel might make might be lawfully sustained;* but the complaint and evidence in this case have satisfied that equity and justice demand that that this course should not be pursued." * * *(Italics supplied.)

This states exactly the contention of petitioners. The Court of Appeals holds herein, as shown above, that the separate legal entity of the corporation will not be disregarded except to "circumvent fraud". We do not so understand the rule in regard to its application. We contend that the correct rule is announced in the City of Winfield case, as follows: That the legal entity of the corporation will be disregarded when substantially all of its stock is owned by one person, and such a course is demanded by equity and justice. Of course, we do not contend that the rule does not also apply when necessary to prevent fraud, but we do say that it does not apply only to cases of fraud.

The other cases cited, the Aiello case, is a bankruptcy case. It is not shown what per cent of the stock in the corporation Aiello owned, except that he owned most

of the stock". The Court refused to apply the alter ego doctrine. Suppose that Aiello had owned, not merely most of the stock, but all of it, except qualifying directors shares, what would have been the holding then? Let the Court of Appeals of the Fifth Circuit itself answer this question in a case presenting facts somewhat similar: Jackson vs. Thomas, 46 Federal (2) 252. M. H. Thomas individually executed the note sued upon. The note was endorsed by the M. H. Thomas Investment Company, a corporation, of whose stock Thomas, the maker of the note, owned sustantially all the stock. The corporation endorser plead in defense ultra vires, no authority from the Board of Directors authorizing Thomas as President of the corporation to endorse the note, and want of consideration.

> "The reply of the plaintiff to these defenses is that the corporate defendant was the alter ego of the individual maker of the note, and that the law will, for that reason, disregard the separate identity of the corporation and treat its property as the property of the individual maker, as much so as if the title were in him, instead of being in the corporation.
>
> "The law", says the Court, "is so settled, in cases where the corporation is the mere alter ego of the indivdual and in which the rights of creditors and other third persons of the corporation are not involved."

The Court of Appeals, after holding that, as a general rule, the corporation and the stock holders are essentially distinct (which we concede); further held that, to circumvent fraud, the corporate entity may be disregarded; and the fact that one person owns substantially all of the stock of the corporation does not affect the matter, and

> "Particularly is it true as regards matters of taxation and matters of governmental fisc, that the members of a corporation and the corporation itself are essentially different entities."

In support of the last holding it cited the case of Klein vs. Supervisors, supra, and the additional cases of Darby Linde Company vs. Commissioner, 51 Federal (2) 32; Marr vs. U. S., 268 U. S. 536, 45 Sup. Ct. Rep. 575, 69 Law Ed. 1079. We have examined the cases cited, and respectfully submit that neither of them determines the question here. That tax cases do arise in which the Courts correctly apply the rule that the entities of the corporation and of the stockholders are distinct cannot, of course, be denied. If it is the holding of the Circuit Court of Appeals in the instant case (and we believe that it is) that the Courts will in every instance, as regards taxation, treat the members of the corporation and the corporation itself as essentially different entities, unless tinctured with fraud, we submit that the Court of Appeals is in error, and that it does so hold is shown by the further language used:

"Fradulent pretense absent, the government accepts the tax payer as it represents itself to be, and one may not, chameleonlike, change that appearance to suit his necessity or conscience."

The cases cited in the original brief specifically cite tax cases, decided by this and other Federal Courts, holding to the contrary. Brief in support of the Petition, pages 23-31. The very proposition for which we here contend was sustained in the *Slag* case (Circuit Court of Appeals, Third Circuit), 47 Federal (2) 846. The Court of Appeals in the instant case expressly admitted that the decision in the Slag case supports petitioners' contention, but refuse to follow it.

It is simply the position of petitioners that the acceptance of the "alter ego", or "fiction" theory in respect to a corporation and its stockholders is not confined to any particular line of cases, nor does it depend upon any particular state of facts. It applies in any kind of a case, including tax cases, when the facts of that particular case justifies its application, whether to prevent a fraud or to prevent a wrong or to prevent a crime, and even in cases where public convenience demands it.

In the case of Boatright vs. Radio Corporation, (CCA 10) 46 Federal (2) 385, the Court says:

"Corporate entity may be disregarded in cases where not to do so will defeat public convenience, justify wrong, protect fraud, or defend crime."

The substance of the above language was used in the case of United States vs. Milwaukee Refrigerator Transit Company, 142 Federal 247, and has since been used in other cases with approval.

In the case of Hamilton Ridge Lumber Company vs. Wilson 25 Federal (2) 592, 595 (CCA 3), the Court says:

> "Nor can I agree with the contention of counsel for the bank that this doctrine (of looking behind the corporate set up) is applicable only in cases where the corporate entity has been resorted to for purely fraudulent and criminal purposes. I do not find that the rule is subject to any such limitation, but, on the contrary it is applicable wherever reason and justice require its application, though the act of the parties amounts to constructive fraud only". (Citing authorities) "In support of his contention, that the rule is applicable only in cases where actual fraud is involved, counsel for the bank cites Cannon Mfg. Co. vs. Cudahy Packing Co., 267 U. S. 333, 49 Sup. Ct. Rep. 250, 69 L. E. 634; and Conely vs. Mathieson Alkalai Works, 190 U. S. 406, 23 Sup. Ct. Rep. 728, 47 L. E. 1113, but I submit that an examination of these cases will show that, as far as the facts are concerned, neither of them is in point."

In 7 R. C. L., page 27, is found the following language:

> "The doctrine, however, that a corporation is a legal entity existing separate and apart from the persons composing it is a mere fiction, introduced for the purpose of convenience and to subserve the ends of justice. This fiction cannot be urged to an extent and purpose not within its reason and policy, and it has been held that, in an appropriate case, and in furtherance of the ends of justice a corporation and the individual or individuals owning all its stock and assets will be treated as identical * * *." * * * Again corporate existence as an entity distinct from its members may be ignored in order to circumvent the fraudulent purpose of the share holders in its organization."

No one, we suppose, could be found who would contend that the courts would not be justified in looking through corporate form, if necessary so to do, in order to prevent the government from collecting a tax otherwise just and righteous. Then why deny the courts that same right in order to prevent the collection of a tax that is both unjust and unrighteous? The Circuit Court of Appeals in its opinion practically admits that the tax is unjust when it says that the facts of this case, as well as those in the Slag case, present a situation

> "of which, if the matter were to be determined upon consideration of general fitness, it might well

be said, as the Court did in the Slag case: 'It seems on principle that the provisions of Section 206 should apply to the consolidated return of these affiliated companies."

The Circuit Court of Appeals further says that the law stands in the way of affording protection to the citizen, which he would otherwise, on the ground of "general fitness", be entitled, as his rights "must rest upon the express terms of the statute." But the Circuit Court of Appeals does not refer to the express terms of any statute. However, it cites the cases of Woolford vs. Rose, Busch vs. Commissioner, 50 Federal (2) 800, and First National Bank of Chicago vs. U. S., 283 U. S. 142, 51 Sup. Ct. Rep. 378; 75 L. E. 913.

In the case of First National Bank of Chicago vs. U. S., supra, it appears that the Bank was affiliated with two other corporations, the Joint Stock Land Banks of Chicago and Dallas. As we understand the ruling therein made, it was that the National Bank was not allowed to make deductions on account of interest paid or accrued upon the outstanding bonds of the two joint stock land banks, affiliated with it, not on the ground that the loss must be purely personal to the individual tax payer sustaining it, but on the grounds:

(1) Section 234 of the Revenue Act plainly provides that no deduction should be made for interest paid

on indebtedness incurred to purchase securities or carry obligations, the interest upon which, as was the case of the land banks, was wholly exempt.

(2) Section 213 provides that "gross income" does not include interest upon "securities issued under the provisions of the Federal Farm Loan Act. * * *"

It is a long way from the facts of that case to the facts of the one at bar. Petitioners earnestly insist that there is not to be found the "express terms" of any statute supporting the views of the Circuit Court of Appeals in the instant case, as there was to support the Court's views in the Chicago Bank case. We readily concede that "general fitness" would have to submit to the express terms of the statute where there is one; but general propositions derived from decisions are not tantamount to "express terms" of a statute. We submit that, in the absence of "express provisions of a statute", the case should be determined by its own equities, or "general fitness" to be derived from the facts of that case. We know of but one case "on all fours" with this one, the Slag case, admittedly in point as to facts, decided by the Circuit Court of Appeals, Third Circuit, and which fully sustains petitioners' contention. Not only do petitioners take issue with the Court of Appeals in its conclusion that the "express terms" of some undesignated statute precludes the court from disregarding a paper or book set up as is the case here, thereby com-

pelling payment of a substantial amount of taxes upon an income that never in fact existed, but, on the contrary, we submit that the statute contemplates the very thing we contend for, in that it provides that where one person owns more than 95% of the stock in two or more separate corporations, such corporations may become affiliated and make a consolidated return. (Section 993, I. R. Act.) Upon no apparent theory may such corporations become affiliated except for the reason that the one person who owns substantially all the stock in each of the corporations is in reality the tax payer and the tax ultimately falls upon him.

The case is respectfully submitted with the prayer that the judgment of the Courts below be reversed.

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FILE COPY

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CHARLES ELMORE

No. 672

In the Supreme Court of the United States

OCTOBER TERM, 1931

PLANTERS COTTON OIL COMPANY, INC., OF WAXAHACHIE, TEXAS, ET AL., PETITIONERS

v.

GEORGE C. HOPKINS, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

In the Supreme Court of the United States

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The question presented is whether statutory net losses sustained by two joint stock associations during their taxable year ending in 1924, when they were not affiliated with any other corporations, may be used as a deduction in computing consolidated net income for the next succeeding taxable year, during which the two associations were affiliated

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with three other corporations[1] and again had no net income but suffered losses. The question is substantially the same as that presented in *Woolford Realty Company, Inc.* v. *Rose,* No. 582, October Term, 1931, in which this Court recently granted a writ of certiorari. The statute under which the right to take the net loss deduction is claimed is the same as that involved in the *Woolford* case, Section 206 (b), Revenue Act of 1926, c. 27, 44 Stat. 9, 17.

The Government did not oppose the petition for certiorari in that case since it was believed that the decision, in principle, was in conflict with *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846 (C. C. A. 3d), which involved an identical provision in an earlier Act, Section 206 (b) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 260. In the *Woolford Realty* case, the question was whether net losses sustained by a corporation in 1925 and 1926, before it became a member of an affiliated group in 1927, might be deducted in computing the net income of the group for 1927 despite the fact that the member which had suffered the net losses had no net income for 1927. In the *National Slag* case one Buckland had during 1922 and 1923 owned practically all the interest in two businesses, one incorporated and the other not. The latter was incorporated in 1924, Buckland owning practically

[1] The two joint stock associations are considered to be corporations for the purposes of the Revenue Act. Sec. 2 (a) (2), Revenue Act of 1926, c. 27, 44 Stat. 9.

all its stock. For the year 1924 a consolidated return for the two corporations was filed. The Circuit Court of Appeals held that the net losses sustained by the old corporation in 1922 and 1923, before the affiliation, might be deducted in computing the consolidated net income for 1924, despite the fact that the old corporation had no net income for that year. Since in the present case the same individual owned practically all the interest in the two joint stock associations before affiliation and practically all the interest in all five organizations, after the creation of the three new corporations, the decision below seems squarely in conflict with the *National Slag* case.

We suggest that action upon the instant petition be deferred until the decision of this Court in the *Woolford* case. If our contentions prevail in that case, it would seem that this petition should be denied.

Respectfully submitted.

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BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 24–27) is reported in 47 F. (2d) 659. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 32–35) is reported in 53 F. (2d) 825.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 20, 1931. (R. 35.) Petition for certiorari was filed February 1, 1932, and was granted March 21, 1932. (R. 36.) Jurisdiction is

conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Two affiliated Texas joint-stock associations had a net loss for the taxable year ending in 1924. Three corporations were formed in the following taxable year with which the associations became affiliated. All of the corporations had a net income for that year, but both associations again sustained a loss. The consolidated return for all five companies showed a net income for the year. May the affiliated group deduct the net losses sustained by the associations for the taxable year ending in 1924 in computing the taxable income of the consolidated group for the taxable year ending in 1925?

This question is the same as that presented in *Woolford Realty Co.* v. *Rose, Collector,* No. 582, October Term, 1931, now pending on certiorari.

2. Whether, if the above question is answered favorably to the Collector in the *Woolford case,* the instant case should be distinguished from it and the net losses of the associations for the preceding year be deducted in computing the consolidated net income for the taxable year, because one person owned practically all of the stock of all the companies here involved during the years in question.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in the Appendix, *infra,* pages 13–17.

STATEMENT

This suit was brought in the District Court for the Northern District of Texas to recover $8,881.80, paid as income taxes and interest by the Planters Cotton Oil Company (Inc.), Waxahachie, Texas, for the fiscal year ending June 30, 1925. (R. 1, 4, 7.) The parties having waived a trial by jury (R. 8), the court made the following findings of facts (R. 21–23, 9–16):

Petitioners Planters Cotton Oil Company, Waxahachie, Texas, and Planters Cotton Oil Company, Ennis, Texas, were joint-stock associations, H. N. Chapman owning 1,475 of the 1,500 shares of the stock of the former and 2,457 of the 2,500 shares of the latter. (R. 11.) The two associations filed a consolidated return as affiliated corporations for the fiscal year ending June 30, 1924, showing a total net loss of $206,031.03.

On August 18, 1924, two of the other petitioners, Planters Cotton Oil Company, Inc., Waxahachie, and Planters Cotton Oil Company, Inc., Ennis, were incorporated under the laws of Texas, and on September 6, 1924, the remaining petitioner, Farmers Gins, Inc., was also incorporated under the laws of Texas. The two joint-stock associations and the three corporations were affiliated during the fiscal year ending June 30, 1925. (R. 11–12.) H. N. Chapman received 1,940 of the 2,000 shares of the stock of the Planters Cotton Oil Company, Inc., Waxahachie, 2,940 of the 3,000 shares of the

Planters Cotton Oil Company, Inc., Ennis, and 1,204 of the 1,250 shares of Farmers Gins, Inc. This stock was issued in consideration of the transfer to the corporations of certain assets held by the two joint-stock associations. (R. 12.)

On September 17, 1925, the five petitioners filed a consolidated income-tax return for the fiscal year ending June 30, 1925, showing a net income of $69,237. (R. 12–13.) Each of the corporations reported net income for the year, totaling $147,636.25, while the two joint-stock associations each reported a net loss, totaling $78,399.25.

This return did not set forth any claim for deduction of the net loss sustained by the joint-stock associations for the fiscal year ending June 30, 1924. (R. 14.) The Planters Cotton Oil Company, Inc., Waxahachie, paid the total tax computed on the consolidated return, which amounted to $8,654.62, together with $54.80 interest. Later an additional tax of $173.10 was assessed against the affiliated companies and was also paid by Planters Cotton Oil Company, Inc., Waxahachie. (R. 13.)

On September 15, 1927, there was filed an amended consolidated return for the taxable year in question, together with a claim for refund in which it was asserted that a deduction against the total net income of the three corporations should be allowed for the net loss sustained by the two joint-stock associations during the preceding taxable year. (R. 14.) It was agreed that if this net

loss should be allowed, the consolidated group had no taxable net income for the year in question. (R. 14.) The Commissioner of Internal Revenue rejected the claim for refund on March 26, 1928. (R. 15.)

The District Court gave judgment against the petitioner (R. 18–19), and this action was affirmed by the Circuit Court of Appeals (R. 35).

SUMMARY OF ARGUMENT

This case involves substantially the same question as that in *Woolford Realty Co., Inc.*, v. *J. T. Rose, Collector of Internal Revenue,* No. 582, October Term, 1931, now pending on writ of certiorari. Its disposition should be determined entirely by the decision of this Court in the *Woolford case,* and the arguments set forth in the brief for the Collector in that case are equally applicable here. The fact that in this case one person owned substantially all of the stock of the five affiliated companies during the taxable year involved, and also all of the stock of the two associations during the preceding taxable year when they were not affiliated with the three corporations, does not distinguish it from the *Woolford case.* The taxpayers in the instant case are the five companies, and not Chapman, the owner of their stock. To allow the distinction contended for by petitioners would necessitate disregarding corporate entities, contrary to settled law. *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846 (C. C. A. 3d), is contrary

to the decision of the court below in the instant case, and, we believe, incorrect. The decisions of this Court cited by petitioners in support of their contentions do not involve the question of a deduction and are distinguishable.

ARGUMENT

I

This case involves substantially the same question as that presented in *Woolford Realty Co., Inc.*, v. *J. T. Rose, Collector of Internal Revenue,* No. 582, October Term, 1931, now pending on writ of certiorari. Two affiliated joint-stock associations [1] sustained statutory net losses for the taxable year ending in 1924. During the fiscal year ending in 1925 the two associations were affiliated with three other corporations created during that year. The associations again suffered losses for that year, but the corporations all reported net incomes. The consolidated return of all five organizations for that year showed a net income; but if the net losses of the associations for the fiscal year ending in 1924 should be deducted in computing the consolidated net income for the following taxable year, there would be no consolidated net income. Petitioners contend this deduction should be allowed under Section 206 (b) of the Revenue Act of 1926. (*Infra,* p. 14.) For the reasons set forth in the

[1] Joint-stock associations are corporations within the meaning of the Revenue Acts. (Section 2 (a) (2), Revenue Act of 1926, c. 27, 44 Stat. 9.)

brief for the Collector in the *Woolford case* we believe that it should not be allowed and that the decision of the court below was correct. Should this Court decide in favor of the petitioner in the *Woolford case*, it must necessarily give judgment for the petitioners here.

II

We believe that the decision in the *Woolford case*, regardless of which way it is decided, will be determinative of the instant case. The petitioners, however, argue that even if the *Woolford case* is decided against the petitioner there, this case should be decided in their favor. They contend that because one individual owned practically all of the stock of all five companies during the taxable year involved and also of the associations during the preceding taxable year, this fact distinguishes the instant case from the *Woolford case*. As the assets of the corporation came from the associations, it is urged that there was in reality a business unit with one real owner during both of the years in question, and as this owner suffered a net loss in the business unit during one year he should be allowed to deduct the loss from its net income for the following year. If this is not allowed, it is said that the owner will be unjustly deprived of a deduction which he suffered in his business during a preceding year and which is ordinarily allowed under the statute where a single business unit is involved. The court below held that the rule which

it applied in the *Woolford case* was equally applicable here and that ownership of the stock in all of the companies by one individual did not affect the result.

As such a deduction is not provided for in the Revenue Act, for the reasons stated in the respondent's brief in No. 582 it is apparent that the basis of the petitioners' contention is that the corporate entities must be disregarded and the five companies considered simply as a single business personally conducted by Chapman. We believe that a complete answer to petitioners' argument for the disregard of the corporate entities is that Chapman did not choose to operate the business conducted by the five companies individually, nor did he choose to continue the operation of the business wholly by the two joint-stock associations. By creating the three new corporations and transferring to them a portion of the assets of the associations there was effected a change in legal relationships which cannot be ignored by the tax collector. The assets transferred to the corporations were thereafter owned and operated free from the personal liability formerly resting on the stockholders as members of the joint-stock associations. Rev. Civ. Stats., Texas, 1925, Title 105, c. 2, Arts. 6135–6138; *Hollister* v. *McCamey,* 115 Tex. 49; *Manufacturers' E. Co.* v. *Cisco C. & C. Co.,* 118 Tex. 370. The corporations were separate and distinct from the associations. *United States* v. *Phellis,* 257 U. S. 156;

Rockefeller v. *United States,* 257 U. S. 176; *Marr* v. *United States,* 268 U. S. 536. It is, of course, axiomatic that a corporation is an entity separate and distinct from its stockholders. *Eisner* v. *Macomber,* 252 U. S. 189, 213–214; *Peterson* v. *C. R. I. & Pac. Ry.,* 205 U. S. 364. In the absence of fraud or an attempt to evade taxes, the distinction is observed in the application of the revenue laws. *Darby-Lynde Co.* v. *Commissioner,* 51 F. (2d) 32 (C. C. A. 10th), certiorari denied November 2, 1931, 284 U. S. xvii; *McDonald* v. *Commissioner,* 52 F. (2d) 920 (C. C. A. 4th); *Wagner* v. *Lucas,* 38 F. (2d) 391 (App. D. C.).

The language of this Court in *Klein* v. *Board of Supervisors,* 282 U. S. 19, involving the construction of a Kentucky statute taxing corporate shares, is particularly applicable here. It is said (p. 24):

> But it leads nowhere to call a corporation a fiction. If it is a fiction it is a fiction created by law with intent that it should be acted on as if true. The corporation is a person and its ownership is a nonconductor that makes it impossible to attribute an interest in its property to its members. *Donnell* v. *Herring-Hall-Marvin Safe Co.,* 208 U. S. 267, 273.

The five companies, not Chapman, are the taxpayers in the instant case. The statute neither requires nor permits the determination of tax liability by ignoring corporate taxpayers and treat-

ing the problem as if the tax was imposed on their shareholders.

The Board of Tax Appeals has held that where one corporation has acquired all the assets and owned all the stock of another it may not deduct the latter's net loss. *Standard Silica Co.*, 22 B. T. A. 97. The Board has also denied a deduction where the stock of a new company, which had acquired all the assets of a predecessor, was owned by the same individuals in the same proportion as that of the predecessor. *West Point Marion Coal Co.*, 19 B. T. A. 945. In *Athol Mfg. Co.*, 22 B. T. A. 105, a new corporation was formed with the same name as its predecessor, and it took over all the assets and liabilities of the predecessor. An estate owned approximately 94% of the stock of both companies. The Board held that the new corporation could not deduct a net loss sustained by the old. Affirmed as *Athol Mfg. Co.* v. *Commissioner*, 54 F. (2d) 230 (C. C. A. 1st).

The courts have refused to allow one corporation to take the benefit of the deduction of another corporation, or of an individual or vice versa, even where in some cases the stockholders of both have been the same. *Nixon* v. *Lucas*, 42 F. (2d) 833 (C. C. A. 2d); *Burns* v. *Commissioner*, 31 F. (2d) 399 (C. C. A. 5th), certiorari denied, 280 U. S. 564; *Mastin* v. *Commissioner*, 28 F. (2d) 748 (C. C. A. 8th); *Walker* v. *Gulf & I. Ry. Co. of Texas*, 269 Fed. 885 (C. C. A. 5th).

The decision of the Circuit Court of Appeals for the Third Circuit in *National Slag Co.* v. *Commissioner,* 47 F. (2d) 846, is directly contrary to the decision of the court below. We believe that the decision in the *Slag case* is wrong, for the reasons set forth above and for the additional reasons indicated in respondent's brief in the *Woolford case.* A deduction should not be allowed "on principle," as in the *Slag case,* but only if authorized by statute.

Petitioners cite *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71, in support of their contentions in this case. We believe that these cases are distinguishable. Neither case involved the question of a statutory grant of a deduction. Each depends upon its peculiar facts presenting a situation which this Court felt would justify the view that a parent company had actual possession and control before March 1, 1913, of amounts sought to be taxed as dividends because of domination of its subsidiary. In both cases one corporation, the taxpayer, owned the stock and exercised control over another corporation. The language of the Court in those cases is to be construed in the light of these facts and it certainly can not be interpreted to mean that the separate corporate entity is to be respected when that will be of advantage to its stockholders but that it must be disregarded when that will operate to the

detriment of the stockholders, as petitioners apparently contend.

CONCLUSION

The decision of the court below was correct and should be affirmed.

Respectfully submitted.

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APRIL, 1932.

APPENDIX

Revenue Act of 1924, c. 234, 43 Stat. 253, 260:

SEC. 206. (a) As used in this section the term "net loss" means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations. (U. S. C., Title 26, Sec. 937.)

* * * * *

Revenue Act of 1926, c. 27, 44 Stat. 9, 10, 17, 41, 46:

SEC. 2. (a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

* * * * *

(9) The term "taxpayer" means any person subject to a tax imposed by this Act. (U. S. C. Sup. V, Title 26, Sec. 1262.)

SEC. 200. When used in this title—

(a) The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The term "taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations pre-

scribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1925, shall be the calendar year 1925 or any fiscal year ending during the calendar year 1925. (U. S. C. Sup. V, Title 26, Sec. 931.)

SEC. 206. (b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"); and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * *

(e) If for the taxable year 1923 a taxpayer sustained a net loss within the provisions of the Revenue Act of 1921, or if for the taxable year 1924 a taxpayer sustained a net loss within the provisions of the Revenue Act of 1924, the amount of such net loss shall be allowed as a deduction in computing net income for the two succeeding taxable years to the same extent and in the same manner as a net loss sustained for one taxable year is, under this Act, allowed as a deduction for the two succeeding taxable years.

* * * * *

(g) The benefit of this section shall be allowed to the members of a partnership, to an estate or trust, and to insurance companies subject to the tax imposed by section 243 or 246, under regulations prescribed by the Commissioner with the approval of the Secretary. (U. S. C. Sup. V, Title 26, Sec. 937.)

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, * * *. (U. S. C. Sup. V, Title 26, Sec. 984.)

SEC. 240. (a) Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as pro-

vided in subdivision (b) of section 236. (U. S. C. Sup. V, Title 26, Sec. 993.)

Regulations 69:

ART. 635. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. Only one specific credit of $2,000, as provided in section 236 (b) and article 591, shall be allowed the consolidated group, and this only in case the net income of the group does not exceed $25,000; but if such net income is more than $25,000, the tax imposed by section 230 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000. In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited.

ART. 1622. *Claim for allowance of net loss.*—A taxpayer sustaining for any taxable year a "net loss" as defined in section 206 (a) and article 1621 may file a claim therefor with his return for the succeeding taxable year (referred to in article 1623 as the "second year"). The claim should contain a concise statement setting forth the amount

of the net loss and all pertinent facts relative thereto, including a schedule showing the computation of the net loss in accordance with section 206 and articles 1621 and 1626. If the evidence furnished satisfies the Commissioner that the taxpayer has sustained a "net loss," the amount of such net loss may be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year, and if such net loss is in excess of the net income (computed without such deduction (for that year, the amount of the excess may be carried over and allowed as a deduction in computing the net income for the next succeeding taxable year (referred to in article 1623 as the "third year"). It should be noticed, however, that a "net loss" for a preceding year may not be considered in computing a "net loss" for a succeeding year. (See section 206 (a).)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1931

No. 672

PLANTERS' COTTON OIL COMPANY, INC., *et al.*,
PETITIONERS,

v.

GEORGE C. HOPKINS, Collector of Internal Revenue for the Second District of Texas,
RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE AND BRIEF OF AMICI CURIAE

FREDERICK H. WOOD,
HOYT A. MOORE,
A. JAMES SLATER,
Amici Curiae.

CRAVATH, DE GERSDORFF, SWAINE & WOOD,
Of Counsel.

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v.

GEORGE C. HOPKINS, Collector of Internal Revenue,
RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE

May it please the Court:

The undersigned respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amici curiae*.

FREDERICK H. WOOD,
HOYT A. MOORE,
A. JAMES SLATER,
Amici Curiae.

IN THE

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PETITIONERS,

v.

GEORGE C. HOPKINS, Collector of Internal Revenue,
RESPONDENT.

BRIEF OF AMICI CURIAE

THE QUESTION PRESENTED

The question presented by the case at bar[1] is whether under the provisions of the Revenue Act of 1926[2] a statutory net loss sustained by a company during a year in which it was affiliated with other companies and which net loss in the year in which it was sustained was not absorbed in the process of calculating the consolidated net income of the affiliated group for that year may in the succeeding year be allowed as a deduction in calculating the consolidated net income of the same affiliated

[1]The opinion of the District Court in this case is reported in 47 Fed. (2nd) 659, and of the Circuit Court of Appeals, Fifth Circuit, in 53 Fed. (2nd) 825.

[2]c. 27, 44 Stat. 9 *et seq.*

group, even though the affiliated company which sustained the loss in the preceding year sustained an additional loss in the succeeding year, in which period the other members of the affiliated group had net incomes.

STATEMENT OF FACTS

The facts in this case, having been fully outlined in the briefs of the parties in interest, are here stated schematically as follows:

Tax Yr.	Company I Waxahachie Association[3]	Company II Ennis Association[3]	Company III Farmers' Gins, Incorporated	Company IV Planters Oil Company, Waxahachie	Company V Planters Oil Company, Ennis
1924	NET LOSS	NET LOSS	(Not in existence)	(Not in existence)	(Not in existence)
1925	LOSS	LOSS	INCOME	INCOME	INCOME
	Throughout each of the years Chapman owned over 96% of the stock of all companies in existence in that year. (R. 11-12.)				

Companies I and II filed a consolidated return for the taxable year 1924. During the taxable year 1925[4] Chapman organized Companies III, IV and V[5] and transferred to them certain of the assets of Companies I and II in consideration of the issue to Chapman of substantially all of the stock of Companies III, IV and V (R. 12.). The assets so transferred were the entire assets of the new companies.

---

[3]A joint stock association (R. 11.), which under the provisions of the Revenue Acts is treated as though it were a corporation (Sec. 2(a) (2), Rev. Act of 1926).

[4]Such taxable year ended June 30, 1925.

[5]Company III was incorporated on September 6, 1924; and Companies IV and V were incorporated on August 18, 1924.

The question presented by the case at bar may be restated as follows: May the 1924 net losses of Companies I and II be deducted from the 1925 incomes of Companies III, IV and V in calculating the 1925 consolidated net income of all five companies, it being conceded that the 1925 losses of Companies I and II may be properly so deducted?[6]

The case at bar is to be carefully distinguished from its companion case, *Woolford Realty Company* v. *Rose* (hereinafter referred to as the *Woolford* case),[7] the pertinent facts in which may be stated schematically as follows:

Tax Yr.	Company I Piedmont Savings Company	Company II Woolford Realty Company
1925	NET LOSS	(In existence but not affiliated with Company I)
1926	NET LOSS	(In existence but not affiliated with Company I)
	Company I was not affiliated with Company II during these years	
1927	LOSS	INCOME
	During 1927 96% of the stock of Company I was owned by Company II	

[6]Both the District Court (47 Fed. (2nd) 659) and the Circuit Court of Appeals (5th) (53 Fed. (2nd) 825) refused to allow the deduction.

[7]The opinion of the District Court in the *Woolford* case is reported in 44 Fed. (2nd) 856, and of the Circuit Court of Appeals, Fifth Circuit, in 53 Fed. (2nd) 821; the *Woolford* case is No. 582 on the calendar of the Supreme Court of the United States for the October term 1931 (*certiorari* granted on January 25, 1932).

Companies I and II filed a consolidated return in 1927. The question presented in the *Woolford* case may be stated as follows: May the 1925 and 1926 net losses of Company I, which were sustained prior to its affiliation with Company II, be deducted from the 1927 income of Company II in computing the 1927 consolidated net income of Companies I and II; it being conceded that the 1927 loss of Company I may be properly so deducted?[8]

The statute which is controlling in both the case at bar and the *Woolford* case is the Revenue Act of 1926. The pertinent provisions of Section 206 (b) of such Act are as follows:

> "If, for any taxable year, it appears * * * that any *taxpayer* has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the *taxpayer* for the succeeding taxable year * * *, and if such net loss is in excess of such net income (computed without such deduction) the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year * * *." [Italics supplied.]

ARGUMENT

(I) THE FUNDAMENTAL PROBLEM INVOLVED.

In view of the provisions of Section 206 (b) of the Revenue Act of 1926, the questions presented in the case

[8]Both the District Court (44 Fed. (2nd) 856) and the Circuit Court of Appeals (53 Fed. (2nd) 825) refused to allow the deduction.

at bar and in the *Woolford* case may be restated as a single, fundamental problem as follows:

When affiliated companies file a consolidated return as authorized by Section 240[9] of the Revenue Act of 1926, who or what is the "taxpayer" as such term is used in Section 206 (b)?

Three possible answers to this fundamental problem have been suggested by the Courts and the Board of Tax Appeals, as follows:

The First Answer

The first answer is that the TAXPAYER is the *underlying economic unit* which over a period of years enjoys the ultimate income or suffers the ultimate loss sustained in the conduct of a business which is carried on through the instrumentality of affiliated corporations.

Under this interpretation of Section 206 (b), the income earned by the underlying economic unit in the operation of its business in one year may be reduced by the total net loss which the same underlying economic unit sustained in the operation of its business in the preceding year. It is the loss or income of the *unit* which is controlling, not the losses or incomes of the various

[9]"Section 240(a). Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. * * *

"(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each * * *."

affiliated companies through which the economic unit may have conducted its business.

The primary inquiries in treating the question of net losses, if this first answer to the fundamental problem be adopted, are:

(1) What income has the economic unit earned this year?

(2) What net loss did the same economic unit, no matter through what agencies or corporations it may have operated, sustain last year?

This answer to the fundamental problem is stated by the Circuit Court of Appeals for the Third Circuit in its opinion in *National Slag Company* v. *Commissioner*, (1931) 47 Fed. (2nd) 846.

The Second Answer

The second answer is that the TAXPAYER is the *collection of affiliated companies* listed in a consolidated return.

Under this interpretation of Section 206 (b), the *sum* of the gross incomes earned in one year by the various affiliated companies listed in a consolidated return may be reduced not only by the *sum* of the allowable deductions accruing to such companies in the same year but also by the *sum* of the net losses sustained by the *same* companies in the preceding years, no matter with what interests, if any, such companies were then affiliated.

The primary inquiries in treating the question of net losses, if this second answer be adopted, are:

(1) What is the *sum* of the gross incomes of the individual affiliated companies listed in a consolidated return this year?

(2) What is the total of the *sum* of the allowable deductions of such companies for this year and the *sum* of the net losses of the *same* companies last year, no matter with what interests, if any, they were then affiliated?

Obviously, if this interpretation be adopted, the underlying business or economic unit is ignored and the *agencies* through which such unit operates are treated as being of controlling importance.

This second answer to the fundamental problem was first adopted by the Board of Tax Appeals in *Sweets Company of America* v. *Commissioner* (1928), 12 B. T. A. 1285, at 1292, reversed by C. C. A. 2nd (1930), 40 Fed. (2nd) 436.

The Third Answer

The third answer is that each *individual company* is a TAXPAYER, despite the fact that it is a member of an affiliated group of companies through which an *underlying economic unit* operates a business.

Under this interpretation of Section 206 (b), as applied by the respondents, the District Courts and Circuit Courts of Appeals in the case at bar and in the *Woolford* case[10], the deduction allowed thereby is limited to

[10]See also *Commissioner* v. *Ginsburg Co.* (1931), 54 Fed. (2nd) 238, at 240: "Even though both corporations were affiliated in 1927, they each remained taxpayers and their affiliation merely made them a tax computing unit. * * * Since each corporation of the affiliated group is a taxpayer, the net loss of each must be computed separately, and a net loss may not be carried forward and added to a net loss of the taxpayer unless the taxpayer has a net income for a succeeding year."

the deduction of the *individual* net loss sustained by *each* company in an affiliated group in one year from the *individual* income earned by the *same* company in the succeeding year or years, despite the fact that any such company may have been affiliated with one group in the first year and an entirely different group in the succeeding year or years.

The primary inquiries in treating the question of net loss, if this application of the third answer be adopted, are:

(1) What are the respective *individual* incomes of the companies in the affiliated group for this year?

(2) What were the *individual* net losses of such companies, *respectively*, last year, no matter with what interests, if any, they were then affiliated?

This application of the third answer to the fundamental problem was originally propounded in *Swift & Company* v. *U. S.* (1930), 38 Fed. (2nd) 365. Thus, as this third answer has been applied by the respondents and the lower courts in the case at bar and the *Woolford* case, the underlying business or economic unit is completely ignored and the agents (i. e. the members of the affiliated group) through which such unit operates are considered as being of controlling importance. As even a cursory examination of the case of *Swift & Company* v. *U. S.*, *supra*, will show, an attempt to operate under this application of the third answer involves complications of far greater complexity than one would ordinarily expect to find as being the result intended by the

legislative forces enacting so simple a statutory provision as Section 206 of the Revenue Act of 1926.

This same answer, namely, that the taxpayer is the individual corporation has also been adopted by the petitioner in the *Woolford* case and by a long line of opinions in the Board of Tax Appeals,[11] and by an ingenious argument such petitioner and the Board have undertaken to justify a conclusion which would have been the logical and expected result, if they had accepted the definition of the term taxpayer which was proposed by the *Sweets Company of America* case, *supra,* namely that the taxpayer is the collection of affiliated corporations.

Though the petitioner in the *Woolford* case begins its argument in its brief filed in this court with the statement that "each corporation is a separate taxpayer", it nevertheless seeks to have allowed as a deduction from its individual 1927 income the net losses sustained in prior years by a Company which, though affiliated with such petitioner in 1927, was in no way associated with it in the preceding years when such net losses were sustained.

The argument by which such result is sought to be accomplished may be summarized as follows:

> SINCE Section 232 provides that "in the case of *a corporation subject to a tax* * * * the term 'net income' means gross income * * * less the deductions allowed by sections *234 and 206* * * *"; and

[11] *Alabama By-Products Corp.* v. *Commissioner,* 18 B. T. A. 919 (1930—non-acquiescence—now pending before C. C. A. 5th Cir.); *Buckie Printers' Ink Co.* v. *Commissioner* (1930), 19 B. T. A. 943; *Hutt Contracting Co.* v. *Commissioner* (1929), 17 B. T. A. 818; *Struthers-Ziegler Cooperage Co.* v. *Commissioner* (1929), 18 B. T. A. 537; *Warren-Nash Motor Corporation* v. *Commissioner* (1930), 21 B. T. A. 897; *Pittsburgh Gasoline Co.* v. *Commissioner* (1930), 21 B. T. A. 297.

SINCE Section 234 provides that "in computing the net income of *a corporation subject to a tax* * * * there shall be allowed as deductions": the ordinary current expenses and losses of the *corporation* (Sec. 234 (a) (1)) or *taxpayer* (Sec. 234 (a) (2), (4)); and

SINCE Section *206* provides that "if any *taxpayer* has sustained a net loss the amount thereof shall be allowed as a deduction in computing the net income of the *taxpayer* for the succeeding taxable year"; and

SINCE in a consolidated return made pursuant to Section 240 the excess of the deductions allowed by Section 234 to an affiliated corporation over the gross income of that corporation is, under the Regulations and by accepted and unquestioned practice, allowed to offset income of other corporations in the affiliated group; and

If the statement of the respondents in the *Woolford* case and the case at bar to the effect that the *taxpayer* is the *individual corporation* in the affiliated group be correct;

Then the deductions allowed to a corporation (i. e. the taxpayer) under Section *206* must be treated in the same way as deductions under Section 234 and be allowed to offset income of other corporations in the affiliated group.

In considering the soundness of this argument it must be noted that the deductions allowed under Section 234 are only allowed in computing the net income *of the corporation subject to the tax* (Sec. 234 (a) (1)) or the *taxpayer* (Sec. 234 (a) (2), (4)); such terms being used by the act indiscriminately. Hence if, as is the unques-

tioned practice, under this section current expenses of corporation A are allowed as deductions from the current gross income of corporation B, with which it is affiliated, then the resulting net income must be the *net income of the taxpayer,* for it is only in calculating the net income *of the corporation* or the *taxpayer* that such deductions may be taken. Since the net income so computed is, in fact, the net income of the *affiliated group of companies,* that group must, when returns are filed under Section 240, be the *taxpayer.*

The intention of the Sections under discussion thus seems clear. When an individual corporation files an individual return, it is the taxpayer and its prior year net losses and current expenses and losses are allowed to it as deductions from its current gross income. But when a consolidated return is filed pursuant to Section 240, the group of affiliated companies is then the *taxpayer* and all prior year net losses and current expenses and losses of that taxpayer, namely the consolidated net losses and current expenses and losses of the affiliated companies, may be deducted by the *taxpayer* from *its* gross income, namely the consolidated gross incomes of the affiliated companies.

We submit that this conclusion is inevitable and correct, if the affiliated group continues unchanged from year to year. If there be, however, changes in the group resulting from the addition or separation of companies therefrom, then this definition of the term taxpayer, as being the affiliated group, may lead to improper results upon which we shall hereafter comment. It is, therefore, the position of this brief that the taxpayer is the continuing business entity which if such entity over a num-

ber of years operates through the same affiliated group of companies is practically the same as and equivalent to the group itself, and it is, we submit, this fact (namely the practical identity of the affiliated group to the underlying business entity in all cases where over a period of years the business entity has operated through an unchanged group of affiliated companies) which has confused the petitioner in the *Woolford* case and the Board of Tax Appeals. Their argument as summarized on pages 9 and 10 is based upon the treatment given to current losses and expenses sustained during a period when the affiliated group has remained unchanged; hence, their argument for a similar treatment of past year net losses is only sound when applied under similar circumstances, that is to a group of affiliated companies remaining unchanged over a period of years.

(II) THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, IN ITS OPINION IN THE NATIONAL SLAG COMPANY CASE, HAS STATED THE ONLY DEFENSIBLE ANSWER TO THE FUNDAMENTAL QUESTION AS TO WHO OR WHAT IS THE "TAXPAYER" WITHIN THE MEANING OF SECTION 206 (b) OF THE REVENUE ACT OF 1926 WHEN THAT SECTION IS APPLIED TO CONSOLIDATED RETURNS FILED PURSUANT TO SECTION 240 OF THAT ACT.

The Court in the *National Slag Company* case, *supra,* defined the TAXPAYER as the fundamental economic unit which over a period of years enjoys the ultimate income or suffers the ultimate losses sustained in the conduct of

a business which is being carried on through the instrumentality of affiliated corporations. The facts in the *National Slag Company* case may be schematically stated as follows:

Tax Yr.	Company I Quakertown & Bethlehem Railroad Company	Company II National Slag Company
1922	NET LOSS	(Not in existence)
1923	NET LOSS	(Not in existence)
1924	LOSS	INCOME

Throughout out each of the years Buckland owned over 96% of the stock of the company or companies in existence in that year.

On January 1, 1924, Buckland organized Company II and a consolidated return for Companies I and II was filed for 1924. The question presented in the *National Slag Company* case may be stated as follows: May the 1922 and 1923 net losses of Company I be deducted from the 1924 income of Company II in computing the 1924 consolidated net income of Companies I and II; it being conceded that the 1924 loss of Company I may be properly so deducted?

In affirmatively answering the question presented in the *National Slag Company* case, that is, in allowing the deductions, the Court, referring to the provisions of Section 206 of the Revenue Act of 1924[12] (which for all

[12] c. 234, 43 Stat. 260.

material purposes are exactly the same as the provisions of the same section of the Revenue Act of 1926), said, at page 847:

> "These sections make it perfectly plain that if the taxpayer in the case at bar had been an individual, he would have had the right to deduct the losses for 1922 and 1923 from his 1924 tax return. * * * The statute does not intimate that its provisions are inapplicable to affiliated corporations. In view of the fact that Buckland owned both companies before and after incorporation of the Slag Company, it seems on principle that the provisions of Section 206 should apply to the consolidated return of these affiliated companies. The return of these companies should be treated as an *economic unit*, and not as separable into various component parts, or individual returns. * * * That one of these instrumentalities forming one of the component parts in the consolidated return was not incorporated until after the losses sought to be deducted were sustained, does not make the provisions on principle inapplicable to the return, for *it was in fact the same instrumentality, but acting in 1924 through corporate forms. * * * The deductions of the losses here in question, sustained in 1922 and 1923, come directly within the provisions of the statute which are plain, certain and unambiguous.*" [Italics and underlining supplied.]

That the Court in the *National Slag Company* case has clearly discerned the true legislative intent expressed in Sections 240 and 206 is abundantly evidenced.

When the Committee on Finance reported to the Senate the first revenue act which authorized the carrying

forward of net losses (Revenue Act of 1918; Section 204[13]) it gave the following explanation of the purposes of the authorization so to do:

> "One of the most important provisions inserted by the Committee is quite new to our tax laws. At the present time no recognition is given to net losses; that is, if in any year, the losses and expenses of a *taxpayer* exceed his gross income, the excess (or in other words the net loss) cannot be carried over into the next year. * * * The chief merit of the present plan is its simplicity of administration. But it does not adequately recognize the exigencies of business and * * * may often result in grave injustice. The Committee has accordingly incorporated an amendment (Sec. 204) which provides that under certain limitations net losses * * * may be deducted in computing the net income of the *taxpayer* for the succeeding taxable year." [Underlining and italics supplied.][14]

With reference to Section 240[15] of the Revenue Act of 1918 which was the first specific statutory authority for the filing of consolidated returns, the Committee on Finance, in reporting to the Senate, said:

> "While the Committee is convinced that the consolidated return tends to conserve, not to reduce, the revenue, the Committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the revenue, but because the *principle of taxing as*

[13]c. 18, 40 Stat. 1061.
[14]Senate Report No. 617, 65th Congress, Third Session, page 7.
[15]c. 18, 40 Stat. 1081.

> *a business unit what in reality is a business unit is sound and equitable and convenient both to the taxpayer and to the Government.*" [Underlining and italics supplied.][16]

Pursuant to the provision of Section 240 of the Revenue Act of 1918, the Commissioner of Internal Revenue issued regulations with respect to the filing of consolidated returns thereunder. Article 631 of such regulations (Regulations 45, 1920 edition) provides:

> "The provisions of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the *true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation.*" [Underlining and italics supplied.]

This Court, in *Handy & Harmon* v. *Burnet* (1931), 284 U. S. 136, has adopted the view expressed by the Committee on Finance and in Article 631 of Regulations 45, when it said, at page 140:

> "*The purpose of §240* was, by means of consolidated returns, *to require taxes to be levied according to the true net income and invested capital resulting from and employed in a single business enterprise, even though it was conducted by means of more than one corporation.*" [Underlining and italics supplied.]

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[16]Senate Report No. 617 (*supra*), page 9.

The Federal Courts have consistently followed this Court in this interpretation of Section 240,[17] and the Bureau of Internal Revenue has with equal consistency maintained the position that the income of a group of affiliated corporations is the income of a single business unit.[18]

That the courts have correctly interpreted the legislative intent in construing these sections of the Revenue Act of 1926 and its predecessors is clearly indicated by the report made by the Committee on Finance to the Senate with respect to the Revenue Act of 1928. As that Act was reported by the Committee on Ways and Means to the House,[19] it had abolished consolidated returns after 1929. The Senate Finance Committee reinserted the provisions permitting the filing of consolidated returns, and, in its report to the Senate, explained the purpose of consolidated returns as follows:

> "The permission to file consolidated returns by affiliated corporations *merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. * * * The failure to recognize the entire business enterprise means drawing technical legal distinctions, as con-*

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[17] *Ice Service Company* v. *Commissioner*, 30 Fed. (2nd) 230, at 231 (C. C. A. 2nd); *Flannery & Co.* v. *Commissioner*, 42 Fed. (2nd) 11 (C. C. A. 34d); *Lavenstein Corp.* v. *Commissioner*, 25 Fed. (2nd) 375, at 376 (C. C. A. 4th); *U. S.* v. *Cleveland P. & E. R. R. Co.*, 42 Fed. (2nd) 413 (C. C. A. 6th); *W. S. Bogle & Co.* v. *Commissioner*, 26 Fed. (2nd) 771, at 772 (C. C. A. 7th); *Fidelity National Bank & Trust Co.* v. *Commissioner*, 39 Fed. (2nd) 58, at 61 (C. C. A. 8th); *Golden Cycle Corp* v. *Commissioner*, 51 Fed. (2nd) 927, at 931 (C. C. A. 10th); *Pelican Ice Co.* v. *Commissioner*, 37 Fed. (2nd) 285 (C. C. A. 5th); *Commissioner* v. *Shillito Realty Co.*, 39 Fed. (2nd) 830 (C. C. A. 6th).

[18] O. D. 415, 2 C. B. 226; A. R. R. 448, 4 C. B. 314; A. R. R. 624, 5 C. B. 234; I. T. 1386, I-2 C. B. 32; I. T. 1600, II-1C. B. 184; A. R. R. 2958, II-2 C. B. 214; S. M. 1530, III-1 C. B. 307; L. O. 1113, III-2 C. B. 36; S. M. 2683, IV-1 C. B. 238; S. M. 3384, IV-1 C. B. 277; I. T. 2261, V-1 C. B. 100; I. T. 2355, VI-1 C. B. 98; G. C. M. 6640, VIII-2 C. B. 212.

[19] House Report No. 2, 70th Congress, First Session, page 20.

> *trasted with the recognition of actual facts.* The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every one of its agencies. *It would be just as unreasonable to demand that an individual engaged in two or more businesses treat each business separately for tax purposes."* [Italics supplied.][20]

The concluding analogy suggested by the Committee on Finance in the foregoing quotation serves as an excellent means of differentiating between the first and third suggested answers to the fundamental problem involved in the case at bar. Let us take as an example individual X operating a butcher shop and a grocery store in 1924 and 1925. In 1924 X earns a net income in the grocery business and sustains a net loss in his operation of the butcher shop; in 1925 he again has a profit in the grocery business but suffers a further loss in his operation of the butcher shop. It is clear that under Section 206 (b) he as a taxpayer who has suffered a net loss in 1924 in his butcher business may, if such net loss is in excess of the income earned in that year in the grocery business, deduct the excess of such 1924 butcher shop net loss from the net income of the

[20]Senate Report No. 960, 70th Congress, First Session, page 14.

grocery business in 1925 even though the butcher business lost money in both years. Now if it be that individual Y in 1924 were conducting a garage, in the operation of which in that year he sustained a net loss, and if on January 1, 1925, individual X purchased the garage from Y and in the operation of the garage in 1925 also sustained a loss, it is equally clear that X would not be entitled to deduct from such 1925 grocery business income the 1924 garage net loss which had been recorded on the books of the garage business during the year in which it was owned by Y. The reason for this is obvious. The net loss provisions provide that the *taxpayer*, that is, the continuing business entity which from one year to another operates a business enterprise, shall be entitled to deduct losses which *it* has sustained in prior years from income which *it* may earn in certain succeeding years.[21] The law does not provide nor contemplate that *one* taxpayer may deduct from its earned income a loss which has been suffered by *another* taxpayer in a preceding year. Failure fully to appreciate this fact, it is submitted, is the foundation of the fallacy upon which the argument for the petitioner in the *Woolford* case is based.[22]

Neither the second nor the third answer which has been suggested to the fundamental question involved makes any approximation of approaching the legislative intent behind Sections 240 and 206. To hold that the taxpayer is the "collection of affiliated companies" as it may exist in any given year regardless of the affiliation

[21]The net loss provision grants a right which is personal to the *Taxpayer*. *Bush* v. *Commissioner*, 50 Fed. (2nd) 800 (C. C. A. 5th), (1931).
[22]See discussion at page 9.

of such companies in prior years, or that the taxpayer is the "individual affiliated company" clearly ignores the "single business enterprise" of which this Honorable Court has spoken in *Handy & Harmon* v. *Burnet, supra.* In fact to adopt either of such views would mean not only the failure to recognize what courts and legislators alike have recognized as the intent behind Sections 240 and 206 (b) but the authorization of applications of such sections which would permit illogical and unjustifiable tax evasions.

If net losses are to follow individual companies as stock control of such companies is transferred from one business or economic unit to another, which is the inevitable result of defining the term "taxpayer" as meaning either each *"individual company"* in an affiliated group or the *"collection of affiliated companies"* in such group, then "net losses" take their place in the market as proper subjects of barter and sale. The successful corporation earning a large income could purchase the stock of a highly *un*successful corporation which over a period of years had sustained heavy unabsorbed losses and would be authorized thus by such losses to offset its own taxable income. It is obvious that the stock of the highly unsuccessful corporation could be purchased at a very nominal figure, but the resulting benefit to the purchasing corporation would, if the losses of the unsuccessful corporation were sufficiently large, be substantial. We submit that the Congress could not have intended that Section 206 be so interpreted as to permit any such outright tax evasion. A definition of the term "taxpayer" which makes of Section 206 a means by which the remaining sections

of the Revenue Act may be flouted must of necessity be false.[23]

(III) THE "TAXPAYER", WHEN SUCH TERM IS APPLIED TO THE PROVISIONS OF THE REVENUE ACT OF 1926 WHICH INVOLVE CONSOLIDATED RETURNS, MEANS THE UNDERLYING ECONOMIC UNIT WHICH IN THE CASE OF A CLASS A AFFILIATION[24] IS THE "PARENT CORPORATION" WHICH "OWNS AT LEAST 95 PER CENTUM OF THE VOTING STOCK OF THE OTHER OR OTHERS", AND IN THE CASE OF A CLASS B AFFILIATION IS THE STOCK OWNING INTEREST (OR INTERESTS) WHICH IS TAXED THROUGH THE "PRINCIPAL REPORTING CORPORATION", AS SUCH TERM IS USED IN ARTICLE 632 OF REGULATIONS 69.[25]

We have shown above (pages 9 to 11) that the provisions of the Revenue Act themselves preclude a decision that, in considering the application of Section 206 (b), the taxpayer is the individual company. It must be the underlying economic unit which, where no change has taken place from year to year in the consolidated group, is, of course, the consolidated group.

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[23]Article 41(c) of Regulations 75 may not be cited to defeat this conclusion since it did not become effective until January 1, 1929. For more than 10 years prior to that date the net loss provisions have been in force and the definition of the term "taxpayer" adopted by this court in the decision of the case at bar will, without benefit of Article 41(c) of Regulations 75, carry out or defeat the clear intent behind the provisions of Section 206 of the Revenue Act of 1926 and the corresponding Sections of the several Revenue Acts beginning with that of 1918.

[24]Section 240(c) of the Revenue Act of 1926: "For the purpose of this Section two or more domestic corporations shall be deemed affiliated (1) [a Class A affiliation] if one corporation owns at least 95 per centum of the voting stock of the other or others, or (2) [a Class B affiliation] if at least ninety-five per centum of the voting stock of two or more corporations is owned by the same interests."

[25]Art. 632, Reg. 69; "The consolidated return shall be filed * * * by the parent or principal reporting corporation in the office of the collector of the district in which it has its principal office."

The provisions of the statute speak for themselves.

> "The term *'taxpayer'* means any *person* subject to a tax imposed by this Act". (Sec. 2 (a) (9); Rev. Act of 1926).
>
> "The term *'person'* means an individual, a trust or estate, a partnership or a *corporation*." (Sec. 2 (a) (1); Rev. Act of 1926).
>
> "Corporations which are affiliated * * * may * * * make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return." (Sec. 240 (a); Rev. Act of 1926).
>
> "In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon between them, * * *. There shall be allowed in computing the income tax only one specific credit computed as provided in Subdivision (b) of Section 236." [which section allowed a $2,000 tax credit to domestic corporations] (Sec. 240 (b); Rev. Act of 1926).
>
> "The consolidated return shall be filed * * * by the *parent* or principal reporting corporation * * *." (Art. 632. Reg. 69).

Thus a consolidated return is treated for all purposes except assessment, as that of one corporate taxpayer, which corporate taxpayer is allowed one corporate credit, and has the financial characteristics, current capitalization and earnings, and past financial history, of the business entity which operates through the affiliated corporations named in the return as filed.

Thus—to paraphrase, and it is submitted, correct the statement made by the Court of Claims in its opinion in the *Swift* case[20] (*supra*)—the *consolidated group*, as such, is not the taxpayer, but is a *tax computing unit: the individual corporations*, which are members of the affiliated group, are not the taxpayers, but are the tax transmitting units, that is, the means by which the taxpayer, the underlying business entity, transmits the tax payable upon its net income to the tax collecting authorities; and the *underlying business entity* is the taxpayer referred to in Section 206 (b).

We submit that it is clear that in the case of a Class A affiliation the underlying economic unit is the parent corporation; that subsidiaries as they are created or acquired must be regarded as becoming a part of that economic unit; that as subsidiaries are dissolved or disposed of they cease to be part of the economic unit; and that where subsidiaries are sold, each assumes or receives a separate economic and taxable status. To use a simply analogy—the parent company is the fruit tree, which remains the fruit tree even though it gain branches by grafting and lose branches by pruning. When a corporation is grafted on a pre-existing group, such corporation does not bring with it losses which it theretofore sustained, because such losses were not losses of the existing group or economic unit.

That such is the correct theory is indicated by T. D. 4022, dated June 14, 1927.

So also it is clear from the provisions of the statute

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[20] *Swift & Co.* v. *U. S.*, 38 Fed. (2nd) 365, at 375; "The consolidated group, as such, is not a taxpayer but a tax computing unit, and the corporations which are members of the affiliated group for the year * * *" are the taxpayers.

itself that in a class B affiliation the economic unit is the stock owning interest (Chapman in the case at bar) or interests which are taxed through the "principal reporting corporation." Thus corporate activity is taxed upon a corporate basis, with corporate deductions allowed and corporate net income definitions applicable, while, at the same time the actual fact of the existence of one underlying business enterprise is not obscured by the fact of the existence of a means by which that enterprise operates, namely, an affiliated group of corporations.

It is further respectfully submitted that the position taken in this brief does not do violence to the corporate entities of the affiliated corporations as was the belief of the Circuit Court of Appeals for the Fifth Circuit which in its opinion in the case at bar said:

> "It is true that the facts of this case * * * do present a situation of which if the matter were to be determined upon considerations of general fitness, it might be well said, * * * 'It seems on principle that the provisions of Sec. 206 should apply to the consolidated return of these affiliated companies'; but the question may not be decided upon such considerations. * * * It is the general rule that the corporation and the stockholders are essentially distinct entities, and though to circumvent fraud the corporate entity may be regarded as a fiction, ordinarily it must be regarded as having a real, a substantial existence. * * * The whole structure of the Federal taxing system is based upon a recognition of and exact compliance with these distinctions. Fraudulent pretense absent, the Government accept the taxpayer as it represents itself to be and one may not, chameleonlike,

change that appearance to suit his necessity or his convenience."[27]

No chameleonlike tactics are or have been attempted by the petitioner in the case at bar. It is not seeking to change its appearance to suit its convenience but merely to secure a proper application of the provisions of the Revenue Acts of the United States which provide, in the language of the Regulations issued by the Commissioner (as authorized by the Acts themselves[28] for the purpose of carrying into effect the intent of Sections 240 and 206), that the intent thereof is to tax "the true net income and invested capital resulting from and employed in *a single business enterprise* even though the business is operated through more than one corporation."[29] That the Federal Government *can* tax such a single business enterprise and *can* for that purpose avail itself of the affiliated group of corporations, through which such enterprise has elected to do business, as a tax computing unit and avail itself of such corporations themselves as tax transmitting units is axiomatic.[30] It would seem, therefore, that the fears of the Circuit Court for the Fifth Circuit for the security of the corporate entity were unfounded. That entity is to continue and to serve the Federal authorities in an effort to levy a just tax upon a single business enterprise in accordance with the clear legislative

[27] *Planters' Cotton Oil Company* v. *Hopkins*, 53 Fed. (2nd) 825, at 826.

[28] Sec. 1101, Revenue Acts of 1926 and 1924; Sec. 1303, Revenue Act of 1921; and Sec. 1309, Revenue Act of 1918.

[29] Article 631, Regulations 45 (1920 ed.).

[30] The power of Congress to tax extends to taxes of every kind and nature and, except as limited by the Constitution, "reaches every subject and may be exercised at discretion". *License Tax Cases*, 5 Wall. (U. S. (462 L. ed. 497) 1866).

intent as expressed in Sections 240 and 206 of the Revenue Act of 1926.[31]

CONCLUSION

It is submitted, therefore, that the opinion in *National Slag Company* v. *Commissioner*, 47 Fed. (2nd) 846, is right; that the decisions in the lower courts in the case at bar are wrong; and that the judgment of the Circuit Court of Appeals for the Fifth Circuit in the case at bar should be reversed.

Respectfully submitted,

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[31] In this brief scant attention has been given to the opinions of the Board of Tax Appeals since on the question at issue its opinions have been too vacillating to be helpful. In *Sweets Company of America* v. *Commissioner* (1928) 12 B. T. A. 1285, reversed in 40 Fed. 2nd 436 (C. C. A. 2nd Cir., 1930), the Board held the "taxpayer" to be "the affiliated group, as such", that is *"the collection of affiliated companies"*, as such term has been used in the foregoing discussion; in the *first Alabama By-Products decision* (1929—16 B. T. A. 1073) the Board held the "taxpayer" to be "each individual affiliated corporation"; in the *second Alabama By-Products decision* (1930—18 B. T. A. 919), based, it is submitted, on an improper application of *Moore Cotton Mills Company* v. *Commissioner* (1929) 17 B. T. A. 662, affirmed in 49 Fed. (2nd) 59 (C. C. A. 4th Cir., 1931), the Board continued to *say* that the "taxpayer" was the individual stockholder, but by means of an argument which is essentially the same as that summarized on page 9 of this brief, permitted deductions of net losses which can only be explained on the theory that the "taxpayer" is the "collection of affiliated companies"; in a great number of cases which followed the *second Alabama By-Products decision* the position there taken was followed unquestioningly (see opinions cited in foot note 11 on page 9); and finally in *Bowman Hotel Corporation* v. *Commissioner* (1931), 24 B. T. A. 1193, 1209-1210, the Board abandoned the *second Alabama By-Products decision* and reverted to the position taken by it in the *first Alabama By-Products decision* in which it said that the "taxpayer" was "the individual corporation" and *followed that statement* to its logical but indefensible conclusions.

SUPREME COURT OF THE UNITED STATES.

No. 672.—October Term, 1931.

Planters Cotton Oil Co., Inc., of Waxahachie, Texas et al., Petitioners, *vs.* George C. Hopkins, Collector of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[May 16, 1932.]

Mr. Justice Cardozo delivered the opinion of the Court.

Three corporations, Planters Cotton Oil Co., Inc., Waxahachie, Planters Cotton Oil Co., Inc., Ennis, and Farmers Gins, Inc., were organized under the laws of Texas in August and September, 1924. Two joint stock associations, Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, which had been organized in earlier years, retained their separate existence. One man, H. N. Chapman, was the owner of 98% of the shares of the unincorporated associations. He caused the assets of those associations, or substantially all of them, to be transferred to the newly organized corporations, and received in return substantially all the shares of stock.

For the fiscal year ending June 30, 1925, the three corporations and the two joint stock associations filed a consolidated income tax return wherein the corporations, which had earned a net income of $147,636.25, claimed a deduction of $78,399.25 for loss suffered by the associations during the year preceding the affiliation. The deduction was disallowed, and suit was brought by the corporation and the associations for the refund of the tax to the extent of the overpayment claimed. The District Court dismissed the petition (47 F. (2d) 659); the Court of Appeals affirmed (53 F. (2d) 825); and by certiorari the case is here.

The controversy is ruled by our judgment in No. 582, *Woolford Realty Co., Inc.* v. *Rose*, unless the fact that in this case one shareholder, Chapman, was the owner of substantially all the shares

of the five affiliated companies supplies an essential element of difference. We think it does not. Chapman was free, if he desired, to continue to do business in an unincorporated form. Preferring the privileges of corporate organization, he brought into being three corporations and did business through them. These corporations are not identical with the unincorporated associations to whose principal assets they have succeeded, and the losses of the associations suffered in an earlier year are not the losses of the corporations that came into existence afterwards.

The judgment is affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.